TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1932

No. 80

MURPHY OIL COMPANY, PETITIONER,

vs.

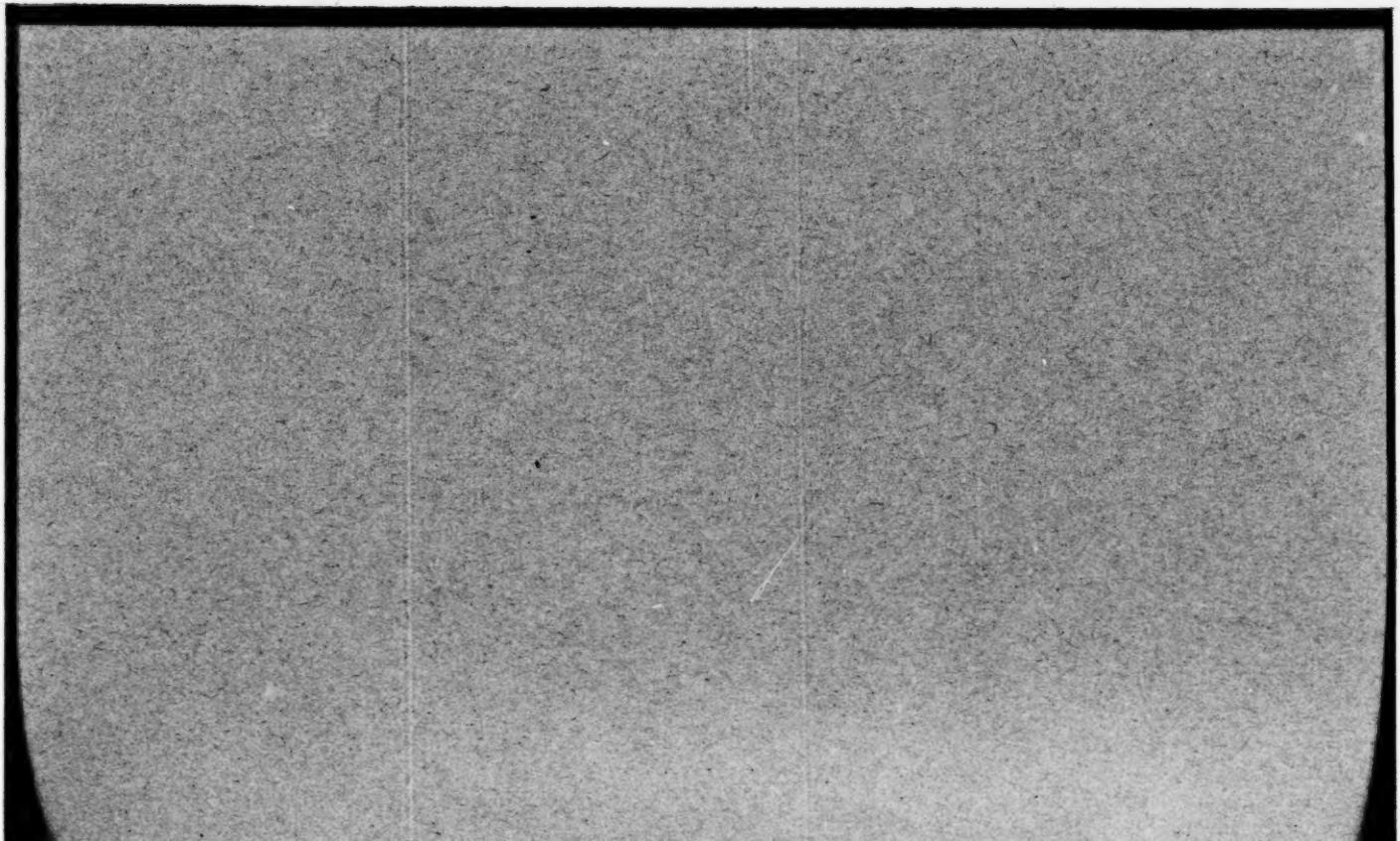
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 16, 1932

CERTIORARI GRANTED MAY 31, 1932

(36,769)



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No. 6388

United States
Circuit Court of Appeals
For the Ninth Circuit

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

Transcript of Record.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filmer Bros. Co. Print, 330 Jackson St., S. F., Cal.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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DOCKET No. 14,440. [1*]

MURPHY OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEARANCES.

For Petitioner: RANDOLPH E. PAUL, Esq.
KENYON F. LEE, Esq.
THOS. R. DEMPSEY, Esq.
ELMONT B. HAZARD, Esq.
GEO. E. HOLMES, Esq.
CHAS. B. McINNIS, Esq.
V. B. HAVENS, Esq.

For Respondent: JOHN D. FOLEY, Esq.
W. F. GIBBS, Esq.

DOCKET ENTRIES.

Mr. MORRIS 11/9/29.

1926.

Apr. 24—Petition received and filed.

May 5—Copy of petition served on Solicitor.

May 5—Notification of receipt mailed taxpayer.

June 24—Answer filed by solicitor.

Aug. 4—Copy of answer served on taxpayer—assigned to General Calendar.

1927.

Feb. 15—Notice of appearance of Elmont B. Hazard as counsel for taxpayer.

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*Page-number appearing at the top of page of original certified Transcript of Record.

1928.

Feb. 20—Hearing date set 4/19/28.

Apr. 3—Motion for leave to file amended petition, amendment tendered, filed by taxpayer.

Apr. 5—Hearing set on motion 4/11/28.

Apr. 5—Copy of motion and amendment served on General Counsel.

Apr. 11—Hearing had before Mr. Littleton on taxpayer's motion to amend—granted. Continued to May 16.

Apr. 11—Ordered motion be granted—case stricken from 4/19/28 to May 16, 1928, entered.

Apr. 14—Answer filed by General Counsel. Copy served 4/19/28.

May 16—Hearing had before Mr. Sternhagen—continued 30 days. Stipulation pending.

May 16—Order of continuance to June 20, 1928, entered.

June 13—Motion to transfer to Reserve Calendar filed by taxpayer.

June 14—Motion granted.

Aug. 17—Motion to set down for hearing filed by General Counsel. Granted Aug. 22, 1928.

Aug. 28—Hearing set Oct. 22, 1928.

Sept. 20—Motion for leave to file second amended petition filed by taxpayer. Amendment tendered.

Sept. 21—Motion granted.

Sept. 22—Stipulation to take depositions filed.

Sept. 24—Copy of motion and amended petition served on General Counsel.

[2] 1928.

Sept. 25—Answer to second amended petition filed by General Counsel. Copy served 9/27.

Oct. 15—Depositions of Kenyon F. Lee filed (2). Notary served taxpayer. 10/16 copy served on General Counsel.

Oct. 22—Hearing had before Mr. Siefkin. Submitted on stipulation. Taxpayer's brief due Dec. 20.

Oct. 29—Transcript of hearing Oct. 22 filed.

Dec. 19—Motion for extension to Jan. 21, 1929, to file brief filed by taxpayer. Granted 12/20/28.

1929.

Jan. 5—Brief filed by General Counsel.

Jan. 21—Brief filed by taxpayer.

Mar. 15—Motion to withdraw original exhibit and substitute copy filed by taxpayer. 3/18/29 granted.

Mar. 30—Findings of fact and opinion rendered—Mr. Siefkin. Judgment will be entered under rule 50.

Dec. 7—Notice of settlement filed by taxpayer. 12/11/29 copy served on General Counsel.

Dec. 10—Hearing set Jan. 8, 1930, on settlement.

1930.

Jan. 8—Hearing had before Mr. Murdock, Division 3, on settlement rule 50. Continued to Jan. 15, 1930.

Jan. 8—Order of continuance to Jan. 15, 1930, on settlement entered.

Jan. 15—Hearing had before Mr. Morris, Division 14, on settlement rule 50. Assigned to Mr. Morris, Division 14 for order.

Jan. 17—Decision entered—Logan Morris, Division 14.

July 11—Petition for review to U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by General Counsel.

July 15—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by taxpayer.

July 16—Proof of service of taxpayer's petition for review filed.

July 17—Proof of service of General Counsel's petition for review filed (attorney).

July 28—Proof of service filed by General Counsel.

Sept. 9—Motion for extension to Oct. 31, 1930, to prepare and transmit record filed by General Counsel.

Sept. 9—Order enlarging time to Oct. 31, 1930, for preparation of evidence and transmission and delivery of record entered.

Sept. 13—Motion for extension to Oct. 31, 1930, to file statement and certify record filed by taxpayer.

Sept. 15—Order enlarging time to Oct. 31, 1930, for preparation of evidence 9th Circuit entered.

Oct. 31—Motion for extension to Jan. 31, 1930, to prepare and transmit record filed by General Counsel.

Oct. 31—Order enlarging time to Jan. 31, 1931, for Commissioner to prepare and transmit record entered.

Oct. 31—Motion for extension to Jan. 31, 1931, to prepare and transmit record filed by taxpayer.

Oct. 31—Order enlarging time to Jan. 31, 1931, for petitioner to prepare and transmit record entered.

[3] 1931.

Jan. 31—Motion for extension to Feb. 28, 1931, to prepare statement and transmit record filed by taxpayer.

Jan. 31—Order enlarging time to Feb. 28, 1931, for preparation of evidence and transmission and delivery of record entered.

Jan. 31—Motion for extension to Feb. 28, 1931, to prepare evidence and transmit record filed by General Counsel.

Jan. 31—Order enlarging time to Feb. 28, 1931, for preparation of evidence and trans-

mission and delivery of record entered.

Jan. 31—Praecipe with proof of service thereon filed by taxpayer.

Now, Feb. 20, 1921, the foregoing Docket Entries certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[4] Filed Sept. 21, 1928. U. S. Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 14,440.

MURPHY OIL COMPANY,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

SECOND AMENDED PETITION.

The above-named petitioner filed a petition with this Board, under date of April 24, 1926, appealing from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter, dated February 6, 1926. Subsequently this petitioner filed an amended petition, under date of April 3, 1928. This second amended petition is hereby filed as an amendment to the original peti-

tion and first amended petition. As a basis for its appeal, the petitioner sets forth the following:

I. The petitioner is a corporation organized under the laws of the State of California, with its home office at Whittier, California.

II. The deficiency letter from which this appeal is made was mailed to the petitioner on February 6, 1926. The sixty-day period within which to appeal to this Board, as granted in that deficiency letter, was subsequently extended to April [5] 26, 1926, by the Revenue Act of 1926. A copy of the deficiency letter from which this appeal is made is attached hereto, marked Exhibit No. 1.

III. The deficiencies asserted in the letter of February 6, 1926, are for income and excess profits taxes for the calendar years 1919 and 1920 and are in the amounts of $76,740.20 and $321,660.33, respectively. The total amounts of these deficiencies are in controversy.

ASSIGNMENTS OF ERROR.

IV. The determination of the deficiencies set forth in the said deficiency letter is based upon the following errors:

(a) The Commissioner erred in refusing to allow as a deduction from net income for the year 1919, the sum of $170,877.24 paid in that year as legal expenses in defending an action against the petitioner for an accounting relative to a portion of its oil properties, to wit, its Coyote Oil properties.

(b) The Commissioner erred in refusing to allow, as a deduction from net income for the year

1919, the sum of $1,200,000 paid in that year in settlement of a suit for an accounting brought against the petitioner relative to its Coyote Oil properties.

(c) The Commissioner further erred in determining that the amounts of $170,877.24 and $1,200,000 paid by the petitioner during the year 1919 and the amount of $32,901.34 paid by the petitioner during the year 1918, in connection with a suit for [6] an accounting, relative to its Coyote Oil property, constitute capital expenditures, and at the same time failing to determine that such amounts should be amortized over the remaining life of the said Coyote Oil property.

(d) The Commissioner erred in deducting from the capital sum returnable through depletion of the petitioner's Whittier Oil property, an amount of $656,192.48 representing a bonus received by the petitioner upon the leasing of the said oil property, in computing the amount of depletion sustained by the petitioner in connection with the said Whittier Oil property for the calendar years 1919 and 1920.

(e) The Commissioner erred in deducting from the capital sum returnable through depletion of the petitioner's Coyote Oil property, an amount of $4,517,402.70, representing a bonus received by the petitioner upon the leasing of the said oil property, in computing the amount of depletion sustained by the petitioner in connection with the said Coyote Oil property for the calendar years 1919 and 1920.

(f) The Commissioner erred in reducing petitioner's depletable base for both the Whittier and

Coyote Oil properties by an amount alleged to represent depletion sustained on the March 1, 1913, value and subsequent cost of the said properties during the period from March 1, 1913, to December 31, 1915, whereas he should have reduced petitioner's depletable base by the amount of depletion which petitioner was legally entitled to take as a deduction in determining its taxable income for the said period from March 1, 1913, to December 31, 1915.

[7] STATEMENT OF FACTS.

V. The facts upon which the petitioner relies as a basis of this appeal are as follows:

(1) The Murphy Oil Company was incorporated on or about August 18, 1904, under the laws of the State of California.

(2) The petitioner corporation, through its agents, purchased from one Domingo Bastanchury by deed dated December 15, 1904, 2,240 acres of land in Orange County, California, at a price of $35 per acre.

(3) The total price paid by the petitioner corporation for the said 2,240 acres of land in Orange County, California, amounted to $79,400.

(4) Subsequent to the purchase of the said land and prior to March 1, 1913, the petitioner corporation discovered that approximately 840 acres of said land contained valuable oil-bearing sands.

(5) On or about August 26, 1918, Maria Bastanchury, the widow of the said Domingo Bastanchury, and administratrix with the will annexed of his es-

tate, filed a complaint in the Superior Court of Los Angeles County, California, against the Murphy Oil Company and the individual, who in 1904 managed the company's affairs and properties, for an accounting of the profits received by the Murphy Oil Company from the said Coyote property.

(6) The Murphy Oil Company employed a number of counsel and took active steps to defend itself.

(7) In its answer to the complaint of the said Maria Bastanchury as administratrix with the will annexed of the estate of Domingo Bastanchury, the Murphy Oil Company denied all the material allegations in the said complaint and vigorously [8] opposed the complainant's prayer for an accounting of the profits received from said Coyote property.

(8) While the case was being prepared for trial, to wit, in the month of April, 1919, it came to the attention of the Murphy Oil Company that said Maria Bastanchury was willing to consider a settlement.

(9) After a long conference on the part of the officials of the Murphy Oil Company, it was decided, in order to minimize the extensive costs of the suit and to avoid as much as possible the disagreeable notoriety accompanying the suit, to settle, if a satisfactory settlement could be made.

(10) After long negotiations through a banker in Los Angeles, the two parties to the suit agreed upon a settlement whereby the said Maria Bastanchury withdrew her request for an accounting and agreed to accept the sum of $1,200,000, in full settle-

ment of any damages that the Estate of Domingo Bastanchury may have suffered as a result of any action of the Murphy Oil Company.

(11) Accordingly a judgment was entered against the Murphy Oil Company for damages in the amount of $1,200,000 under date of April 28, 1919, which judgment was paid immediately thereafter.

(12) The petitioner corporation paid during the year 1918 legal fees and other expense in connection with the above-mentioned litigation in the amount of $32,901.34.

(13) The petitioner corporation during the year 1919 paid legal fees and other legal expenses in connection with the above-mentioned litigation in the amount of $170,877.24.

(14) The petitioner corporation, in its accounts, treated the amount of $32,901.34, paid during the year 1918 in connection [9] with the above-mentioned litigation, as a deductible expense in computing its taxable income for that year.

(15) The Commissioner reversed the petitioner's action and refused to allow the amount of $32,-901.34 as a deduction in computing the petitioner's taxable income for the year 1918.

(16) The Commissioner failed to amortize the said amount of $32,901.34, paid during the year 1918 in connection with the above-mentioned litigation, over the remaining life of the petitioner's Coyote Oil proprty.

(17) The petitioner in its accounts treated the amount of $1,370,877.24, paid during the year 1919

in connection with the above-mentioned litigation, as a loss during the calendar year 1919.

(18) The Commissioner reversed the petitioner's action in treating the above-mentioned amount as a loss and refused to allow any part of the said amount as a deduction in computing taxable net income for the year 1919.

(19) The Commissioner further refused to amortize the said payment of $1,370,877.24, over the remaining life of the petitioner's Coyote Oil property.

(20) The Commissioner determined that petitioner's share of oil reserves in the Coyote Oil property at December 31, 1918, amounted to 5,044,673 barrels.

(21) The Commissioner determined that the amount of oil produced from the petitioner's share of the Coyote Oil property during the year 1919 was 1,644,897 barrels.

(22) The Commissioner determined that the petitioner's share of the oil reserves in the Coyote Oil property at December [10] 31, 1919 amounted to 3,399,776 barrels.

(23) The Commissioner determined that the oil produced from petitioner's share of the Coyote Oil property during the year 1920 amounted to 1,340,237 barrels.

(24) The petitioner leased to the Standard Oil Company, under date of December 1, 1913, its Whittier Oil property and its Coyote Oil property for a one-fourth royalty and a bonus of $5,500,000.

(25) The Commissioner determined that $326,-

404.82 of the bonus represented payment for physical property and that the remaining amount of $5,173,595.18 represented a bonus on the two oil properties.

(26) The Commissioner further determined that $656,192.48 of the said amount of $5,173,595.18 represented a bonus on petitioner's Whittier Oil property and that the remaining amount of $4,517,402.70 represented a bonus on petitioner's Coyote Oil property.

(27) The Commissioner deducted from the capital sum returnable through depletion of petitioner's Whittier Oil property, the said amount of $656,-192.48 representing the bonus applicable to the said Whittier Oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil produced from the Whittier Oil property for the years 1919 and 1920.

(28) The Commissioner deducted from the capital sum returnable through depletion of petitioner's Coyote Oil property, the said amount of $4,517,-402.70 representing the bonus applicable to the said Coyote Oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil produced from [11] the Coyote Oil property for the years 1919 and 1920.

(29) The Commissioner determined that the depletion sustained by the petitioner on its Coyote and Whittier Oil properties during the period from March 1, 1913 to December 31, 1915, was as follows:

Year	Depletion sustained on March 1, 1913, value and subsequent cost.
1913	$257,375.58
1914	153,310.73
1915	34,771.69
Total	$755,458.00

(30) The Commissioner reduced petitioner's depletable base by the above amount of $755,458.00 in determining the amount of depletion allowable for the years 1919 and 1920.

(31) The gross value at the well of all of the petitioner's share of oil produced from its Whittier and Coyote Oil properties during the period from March 1, 1913, to December 31, 1915, amounted to $878,531.23.

(32) Under subdivision G (b) of the Revenue Act of 1913, approved October 3, 1913, the maximum amount of depletion which petitioner was legally entitled to deduct in computing its taxable net income for the period March 1, 1913, to December 31, 1915, was five per cent of the gross value at the well of the oil produced during the said period.

(33) Five per cent of the gross value of petitioner's total share of oil produced from its Whittier and Coyote properties during the period from March 1, 1913, to December 31, 1915, amounted to $43,926.56. The difference between this amount and the amount of depletion alleged to have been sustained on the March 1, 1913, [12] value and subsequent costs, or $711,531.44, represents the amount by which petitioner's depletable base for the two

oil properties has been erroneously reduced in determining the amount of depletion allowable for the years 1919 and 1920.

PRAYERS FOR RELIEF.

The petitioner prays that this Board may determine that the amount of $170,877.24 representing legal expenses paid by the petitioner during the year 1919 in connection with an action for an accounting relative to petitioner's Coyote Oil property constitutes an allowable deduction for the year 1919.

The petitioner further prays that this Board may determine that the amount of $1,200,000 representing damages paid during the year 1919 in connection with an accounting relative to petitioner's Coyote Oil property constitutes an allowable deduction for the year 1919.

The petitioner further prays that if this Board determine that the above-named payments represent capital expenditures, it may determine that the said payments in the total amount of $1,370,877.24 together with the amount of $32,901.34 representing legal expenses paid during the year 1918 in connection with an action for an accounting relative to petitioner's Coyote Oil property, should be amortized over the remaining life of petitioner's Coyote Oil property on the basis of the number of barrels of recoverable oil in said property at December 31, 1918.

The petitioner further prays that this Board may [13] determine that the capital sum return-

able through depletion of petitioner's Whittier Oil property and Coyote Oil property should not be reduced by the amounts of $656,192.48 and $4,517,402.70 respectively, in determining the unit of depletion sustained by the petitioner on oil produced from the said properties during the years 1919 and 1920.

The petitioner further prays that this Board may determine that the depletable base of petitioner's Whittier and Coyote Oil properties should be reduced only by the depletion legally allowable as a deduction from petitioner's taxable income for the period March 1, 1913, to December 31, 1915, in lieu of the depletion determined by the Commissioner to have been sustained on the March 1, 1913, value and subsequent costs.

The petitioner further prays that this Board may duly hear and determine this appeal and reduce petitioner's taxable income by any other deductions to which petitioner is entitled under the Revenue Act of 1918 or subsequent revenue acts.

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RANDOLPH E. PAUL,
CHARLES B. McINNIS,
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KENYON F. LEE,
Attorneys for Petitioner,
Herman W. Hellman Bldg.,
Los Angeles, California.

[14] State of California,
County of Los Angeles,—ss.

Geo. E. Foley, being duly sworn, deposes and says that he is Vice-Pres. of the Murphy Oil Company of Whittier, California, the taxpayer named in the foregoing petition; that he has read the said petition and that the facts set forth therein are true to the best of his knowledge, information and belief.

(Signed) GEO. E. FOLEY.

Sworn to before me this 25th day of Aug., 1928.
[Notarial Seal]

(Signed) TEMPERANCE R. BAILY,
Notary Public in and for the County of Los Angeles, State of California.

[15] EXHIBIT No. 1.

TREASURY DEPARTMENT,
Washington.

Feb. 6, 1926.

Office of
Commissioner of Internal Revenue.
IT:CA:2555–8–60D.
Murphy Oil Company,
Whittier, California.

Sirs:

The determinataion of your income tax liability for the years 1919 and 1920, pursuant to an examination of your books of account and records, as set forth in office letter dated December 12, 1925, disclosed a deficiency in tax amounting to $398,400.53, as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal contesting in whole or in part the correctness of this determination. Any such appeal must be addressed to the United States Board of Tax Appeals, Washington, D. C., and must be mailed in time to reach that Board within the 60-day period.

Where a taxpayer has been given an opportunity to appeal to the Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no

claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file appeal, you are requested to sign the inclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CA:2555–8–60D. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,
D. H. BLAIR,
Commissioner.

By ————————,
Assistant to the Commissioner.

Inclosures:
Statements,
Agreement—Form A.
Form 882.
MF/3.

[16] Feb. 6, 1926.

IT:CA:2555–8–60D.

STATEMENT.

In re: Murphy Oil Company,
Whittier, California.

Deficiency in Tax.

1919	$ 76,740.20
1920	321,660.33
Total	$398,400.53

1919.

Net income, books.....$910,609.09

Additions:		
Income taxes disallowed in accordance with Article 131, Regulations 45		354,316.20
Donations disallowed in accordance with Article 562, Regulations 45.		1,039.16
Legal costs defending title to oil lands in accordance with Article 293, Regulations 45		170,877.24
Settlement of suit attacking title to oil land in accordance with Article 293, Regulations 45		1,200,000.00
Excessive depreciation in accordance with revised schedules		41.09
Total		$2,636,882.78
Deduct:		
Depletion restored excluded from income account the net adjustment due to revising reserves	$ 231,082.20	
Depletion allowed in accordance with engineer's report	2,072,660.49	2,303,742.69
Net income corrected		$ 333,140.09

MF/3.

[17] Statement.
Murphy Oil Company.

		Invested Capital.
Capital Stock		$2,000,000.00
Less:		
Stock discount in accordance with Section 326, Revenue Act of 1918		150,000.00
Capital stock		$1,850,000.00
Surplus—books	$313,433.28	
Plus:		
Adjustments, corrected balance sheet	150,651.22	
Surplus, corrected balance sheet	$464,084.50	464,084.50
Total		$2,314,084.50

	Invested Capital.	
1918 tax prorated in accordance with Article 845, Regulations 45	$ 69,364.70	
Dividends prorated in accordance with Article 858 Regulations 45	712,986.30	782,351.00
Balance.		$1,531,733.50
Deduction:		
Inadmissibles in accordance with Article 852, Regulations 45		28,474.93
Invested capital—corrected		$1,503,258.57
Excess Profits Credit.		
8% of invested capital		$ 120,260.69
Exemption		3,000.00
Total credits		$ 123,260.69

Net Income.	Credit.	Balance.	Rate.	Tax.
$300,651.71	$123,260.69	$177,391.02	20%	35,478.20
32,488.38		32,488.38	40%	12,995.35
Excess profits tax.....				$ 48,473.55
Net income.....		$333,140.09		
Less:				
Profits Tax..48,473.55				
Exemption ... 2,000.00				50,473.55
Taxable at 10%.....		282,666.54		$ 28,266.65

[18] Statement.

Murphy Oil Company.

Taxable at 10%	$282,666.54	$28,266.65
Total tax		$76,740.20
Tax previously assessed		none
Deficiency in tax		$76,740.20

1920.

Net income—books	$2,981,680.14
Add:	
Donations disallowed in accordance with Article 562, Regulations 45	1,246.59
Depletion claimed	102,692.94
Excessive depreciation in accordance with revised schedule	2,930.84
Total	$2,988,550.51

Deduct:		
1918 income tax credited back, due to the same not paid	$ 354,316.20	
Depletion allowed in accordance with engineer's report	1,689,645.13	2,043,961.33
Net income corrected		$ 944,589.18
Invested Capital.		
Capital stock		$2,000,000.00
Less:		
Stock discounts		150,000.00
Capital stock		$1,850,000.00

MF/3.

[19] Statement.

Murphy Oil Company.

Amount brought forward		$1,850,000.00
Deficit—books	$175,957.63	
Add:		
Adjustments, corrected balance sheets	972,087.68	
Surplus, corrected balance sheets		796,130.05
Total		$2,646,130.05
Deduct:		
1919 taxes prorated in accordance with Article 845, Regulations 45	32,342.16	
Dividends prorated in accordance with Article 858, Regulations 45	347,049.17	379,391.33
Balance		$2,266,738.72

Deduction:	
Inadmissible in accordance with Article 853, Regulations 45	42,320.01
Invested capital corrected	$2,224,418.71
Excess Profits Credit.	
8% of invested capital	177,953.50
Exemption	3,000.00
Total credit	$ 180,953.50

Net income	Credit.	Balance.	Rate.	Tax.
$444,883.74	$180,953.50	$263,930.24	20%	52,786.05
499,705.44		499,705.44	40%	199,882.18
$944,589.18				$252,688.23

Net Income.	Credit.	Balance.	Tax
Net income		$944,589.18	
Profits tax.....	$252,668.23		
Exemption	2,000.00	254,668.23	
Taxable at 10%..		$689,920.95	
Tax at 10%.....			68,992.10
	Total tax.....		$321,660.33

MF/3.

[20] Statement.

Murphy Oil Co.

Amount brought forward.....	$321,660.33
Tax previously assessed.....	none
Deficiency in tax.....	$321,660.33

Balance Sheet—December 31, 1918.

Assets.	Books.	Additions.	Reductions.	Amended.
Cash	86,250.87			$ 86,250.87
Notes Receivable	5,432.29			5,432.29
Accts.	270,730.31			270,730.31
Sundry debtors	538,206.10			538,206.10
Farm products	5,141.15	$684.00(2)		5,825.15
Land	72,426.19			72,426.19
Agricultural land	370,285.06	161,700.70(3)		531,985.76
Equipment	441,331.50			441,331.50
Stock	46,252.21			46,252.21
Bonds	70,830.00			70,830.00
Discount capital stock	———	150,000.00(4)		150,000.00
Taxes overpaid	———	73,001.70(5)		73,001.70
Oil Lands	$1,319,200.70		(6)$1,046,207.84	$262,992.86
	$3,226,086.38			$2,555,264.94

Assets.	Books.	Addition		Reductions.	Amended.
Accrued salaries	833.37				833.37
Accrued payroll	4,955.97				4,955.97
Accounts payable	19,197.70				19,197.70
Reserve for depreciation	63,986.95		(7)	2,206.45	56,193.40
Reserve for depletion	823,679.11	823,679.11	(8)		———
Capital stock	2,000,000.00				2,000,000.00
Surplus	313,433.28				464,084.50
	$3,226,086.38				$2,555,264.94

2. To adjust in accordance with books.
3. To set up corrected values of agricultural land.
4. To set up Stock Discount.
5. To set up tax overpayment in accordance with Article 845, Regulations 45.
6. To adjust in accordance with engineer's report.
7. To correct reserve in accordance with revised schedule.
8. Adjusted in asset account.

MF/3.

[21] Statement
Murphy Oil Co.

Balance Sheet—December 31, 1918.

Assets	Books	Additions	Reductions	Amended
Cash	$ 84,747.89			$ 84,747.89
Notes Receivable	2,268.87			2,268.87
Accts.	187,675.13			187,675.13
Sundry debtors	30,623.59			30,623.59
Inventories:				
Packing House	19,714.20			19,714.20
Farm products	1,449.87	684.00 (2)		2,133.87
Land	72,306.19			72,306.19
Agricultural land	370,285.06	161,700.70 (3)		531,985.76
Oil lands	1,319,200.70	(4)	193,908.53	1,125,292.17
Equipment	489,142.28			489,142.28
Stocks	50,309.15			50,309.15
Bonds	90,880.00			90,880.00

Assets	Books	Additions	Reductions	Amended
Cancelled checks	42.00			42.00
Discount on capital stock		150,000.00 (5)		150,000.00
		263,179.96 (6)		263,179.96
Taxes overpaid				
Oil land, March 1, 1913, appreciation	33,673,817.83	(7)	33,673,817.83	
	$36,392,462.76			$3,100,301.06

Liabilities.	Books.	Additions.		
Accrued salaries	$ 833.37			833.37
Accrued payroll	4,965.16			4,965.16
Accounts payable	202,147.11			202,147.11
Reserve for depreciation	94,060.01	(8)	2,165.36	96,225.37
Reserve for depletion on cost	592,596.91	592,596.91 (9)		
Reserve for depletion on appreciation	13,554,444.43	(10)	13,554,444.43	

Liabilities.	Books.	Additions.		
Capital stock	2,000,000.00			2,000,000.00
Earned surplus	———			796,130.05
Deficit	175,957.63			———
Surplus by appreciation of oil land	20,119,373.40			———
	$36,392,462.76	———	———	$3,100,301.06

MF/3.

[22] Statement.

Murphy Oil Co.

2 and 3. As previously explained for the balance sheet—December 31, 1918.

4. Adjusted in accordance with engineer's report.

5 and 6. As adjusted in previous years.

7. Eliminated as balance sheet revised on cost.

8. As explained in previous year.

9. Adjusted through asset account.

10 and 11. Eliminated balance adjusted on cost.

Balance Sheet—December 31, 1920.

Assets.	Books.	Additions.	Reductions.	Amended
Cash	85,600.96			85,600.96
Notes receivable	2,193.95			2,193.95
Accts.	245,109.65			245,109.65
Sundry debtors	206,741.57		177,158.10	29,556.47
Inventories:				
Packing	25,331.85			25,331.85
Farm Products	3,539.45	684.00		4,223.45
Land	72,306.19			72,306.19
Agricultural land	370,285.06	161,700.70		531,985.76
Oil lands	1,319,200.70		608,757.17	710,443.53
Equipment	517,468.99			517,468.99
Stocks	50,309.15			50,309.15
Bonds	380,880.00			380,880.00

Assets.	Books.	Additions.	Reductions.	Amended
Appreciation—oil lands..	$33,673,817.83		33,673,817.83	———
Taxes overpaid	———	9,281.66		9,281.66
Discount on capital stock	———	150,000.00		150,000.00
	$36,952,758.35			$2,814,691.61

MF/3.

[23] Statement.

Murphy Oil Co.

Balance Sheet—December 31, 1920 (Continued).

Liabilities.	Books.	Additions.	Reductions.	Amended
Accrued salaries	$ 1,000.00			$ 1,000.00
Accrued payroll	4,880.54			4,880.54
Accounts payable	20,382.10			20,382.10
Reserve for depreciation	131,665.52	$ 765.48		130,900.04
Reserve for depletion cost	695,289.85	695,289.85		———

Liabilities.	Books.	Additions.	Reductions.	Amended
Reserve for depletion on appreciation	16,133,709.03	16,133,709.03		
Capital stock	2,000,000.00			$2,000,000.00
Earned surplus	425,722.51			657,528.93
Surplus by appreciation	17,540,108.80	17,540,108.80		
	$36,952,758.35			2,814,691.61

Adjustments are as explained in the prior balance sheets.

Analysis of Surplus.

Surplus, December 31, 1918		$ 464,084.50
Net income		333,140.09
Realized appreciation		1,564,082.56
		$2,361,307.15
Dividends	$1,400,000.00	
1918 Taxes	354,316.20	
	1,039.16	1,755,355.36
Balance		$ 605,951.79
Overpayment taxes		190,178.26
Surplus, December 31, 1919		796,130.05
Net income, 1920		944,589.18
Realized appreciation		1,274,796.49
		$3,015,515.72

Dividends	$2,280,000.00	
Donations	1,246.59	2,281,246.59
Balance		$ 734,269.13
Taxes corrected		76,740.20
Surplus, December 31, 1920.		$ 657,528.93

MF/3.

[24] Depletion has been allowed in accordance with the attached revised schedule, based upon a ruling by the Bureau that the judgment and legal costs represent a part of the cost of the property and not additional capital items to be added to the March 1, 1913, value in accordance with Section 326 of the Revenue Act of 1916.

You are advised that your protest submitted by your representatives and received in this office January 12, 1925, has been carefully considered and it is deemed that a conference is not advisable at this time.

Relative to items one and two you are informed that the Commissioner has not acquiesced in these decisions and consequently cannot be allowed. Item three has been adjusted in accordance with your briefs.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district and remittance should then be made to him.

Enclosures:

Revised depletion schedule.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Now, Feb. 20, 1931, the foregoing Second Amended Petition certified from the record as a true copy.

MF/3.

[25] Filed Sep. 25, 1928. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 14,440.

MURPHY OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANSWER TO SECOND AMENDED PETITION.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to second amended petition of the above-named taxpayer admits and denies as follows:

I, II, III. Admits the allegations in paragraphs I, II and III.

V, (1). Admits the allegations in paragraph V, (1).

V, (2), (3), (4),(5), (6), (7), (8), (9), (10), (11), (12), (13). For lack of information upon which to base a belief, denies the allegations in paragraphs V, (2), (3), (4), (5), (6), (7), (8), (9), (10), (11), (12) and (13).

V, (14), (15). Does not regard as material and therefore denies the allegations in paragraphs V, (14) and (15).

V, (16). Admits that the Commissioner failed to amortize the amount of $32,901.34 over the remaining life of the petitioner's Coyote oil property. Denies the remaining allegations in paragraph V, (16).

V, (17). Admits that the petitioner treated the amount of $1,370,877.24 as a loss during the calendar year 1919 in arriving at the net income reported on its income and profits tax return for the year 1919. Denies the remaining allegations in paragraph V, (17).

V, (18). Admits the allegations in paragraph V, (18).

V, (19). Admits that the Commissioner did not amortize the amount of $1,370,877.24 over the re-
[26] Docket No. 14,440.
maining life of the petitioner's Coyote oil property. Denies the remaining allegations in paragraph V, (19).

V, (20). Denies the allegations in paragraph V, (20) and says that in arriving at the deficiency shown in the 60-day letter dated February 6, 1916, the Commissioner determined that the petitioner's share of oil reserves in the Coyote oil property at December 31, 1918, amounted to 5,051,424 barrels and not 5,044,673 barrels as alleged.

V, (21). Admits the allegations in paragraph V, (21).

V, (22). Denies the allegations in paragraph V, (22), and says that in arriving at the deficiency shown in the 60-day letter dated February 6, 1926, the Commissioner determined that the petitioner's share of the oil reserves in the Coyote oil property

at December 31, 1919, amounted to 3,406,527 barrels and not 3,399,776 barrels as alleged.

V, (23). Admits the allegations in paragraph V, (23).

V, (24). For lack of information upon which to base a belief, denies the allegations in paragraph V, (24).

V, (25). Admits that the Commissioner determined that $326,404.82 of the alleged bonus represented an alleged payment for physical property and that the remaining amount of $5,173,595.18 represented an alleged bonus on the two oil properties. Denies the remaining allegations in paragraph V, (25).

V, (26). Admits that the Commissioner further determined that $656,192.48 of the said amount of $5,173,595.18 represented an alleged bonus on the petitioner's Whittier oil property and that the remaining amount of $4,517,402.70 represented an alleged bonus on the petitioner's Coyote oil property. Denies the remaining allegations in paragraph V, (26).

[27] Docket No. 14,440.

V, (27). Admits that the Commissioner deducted from the capital sum returnable through depletion of the petitioner's Whittier oil property, the said amount of $656,192.48 representing the so-called bonus applicable to the said Whittier oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil procured from the Whittier oil property for the years 1919 and 1920.

Denies the remaining allegations in paragraph V, (27).

V, (28). Admits that the Commissioner deducted from the capital sum returnable through depletion of the petitioner's Coyote oil property, the said amount of $4,517,402.70 representing the so-called bonus applicable to the said Coyote oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil produced from the Coyote oil property for the years 1919 and 1920. Denies the remaining allegations in paragraph V, (28).

V, (29), (30). Admits the allegations in paragraph V, (29) and (30).

V, (31), (32), (33). Denies the allegations in paragraphs V, (31), (32) and (33).

Denies generally and specifically each and every allegation in taxpayer's second amended petition not hereinbefore expressly admitted, qualified or denied.

WHEREFORE, it is prayed that the petition be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

JOHN D. FOLEY,
Special Attorney,
Bureau of Internal Revenue.

jdf/9/21/28.

Now, Feb. 20, 1931, the foregoing Answer to Second Amended Petition certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[28] A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 14,440.

Promulgated March 30, 1929.

MURPHY OIL COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

1. Legal expenses and a payment in compromise of a suit alleging petitioner acquired oil properties by fraudulent means and seeking to recover the properties, together with an accounting for profits obtained from dealings with such properties, were not personal expenses, nor were they deductible as business expenses, for that portion allocable to the defense of the claim against title was a capital expenditure.

2. The claim for an accounting was a distinct claim involving a distinct group of assets

and that portion of the expenses and compromise payment allocable to the defense and settlement of such claim, if a capital expenditure, has nothing to do with the oil properties and should not be added to the depletable capital account thereof, and, in the absence of evidence permitting a proper allocation of the expenses and payment between the two claims, no allowance may be made as a business expense or as additional depletion.

3. A cash bonus payment by the lessee for an oil and gas lease represents taxable income and having no relation to exhaustion of resources does not reduce the depletable base of the lessor.

4. The depletable base determining the depletion allowance under the 1918 Act is reduced by the exhaustion actually sustained in prior years and not by the amount of the deductions allowable for prior years under prior Revenue Acts. Thompson Oil & Gas Company followed.

RANDOLPH E. PAUL, Esq., VALENTINE B. HAVENS, Esq., CHARLES B. McINNIS, Esq., THOMAS R. DEMPSEY, Esq., and A. CALDER MACKAY, Esq., for the Petitioner.

JOHN D. FOLEY, Esq., and LLOYD W. CREASON, Esq., for the Respondent.

[29] This proceeding results from a determination of deficiencies in income and excess profits taxes for the calendar years 1919 and 1920 in the amounts of $76,740.20 and $321,660.33, respectively, all of

which are in controversy. The errors assigned are as follows:

(1) The respondent erred in refusing to allow, as a deduction from gross income for the year 1919, the sum of $1,200,000 paid in that year in settlement of a suit for an accounting brought against the petitioner relative to its Coyote Oil properties.

(2) The respondent erred in refusing to allow as a loss deduction for the year 1919 the sum of $170,877.24 paid in that year as legal expenses in defending an action against the petitioner for an accounting relative to a portion of its oil properties, to wit, its Coyote Oil properties.

(3) The respondent further erred in determining the legal expenses incurred in 1918 and 1919 and the amount of the compromise payment in 1919 in connection with such suit constitute capital expenditures, and at the same time failing to determine that such amounts should be amortized over the remaining life of the said oil properties.

(4) The respondent erred in deducting from the capital sum returnable through depletion of the petitioner's Coyote Oil property, an amount of $4,517,-402.70, representing a bonus received by the petitioner upon the leasing of the said oil property, in computing the amount of depletion sustained by the petitioner in connection with the said Coyote Oil property for the years 1919 and 1920.

[30] (5) The Commissioner erred in reducing petitioner's depletable base for both the Whittier and Coyote Oil properties by an amount alleged to represent depletion sustained on the March 1, 1913,

value and subsequent cost of the said properties during the period from March 1, 1913, to December 31, 1915, whereas he should have reduced petitioner's depletable base by the amount of depletion which petitioner was legally entitled to take as a deduction in determining its taxable income for the said period from March 1, 1913, to December 31, 1915.

FINDINGS OF FACT.

Petitioner corporation was organized on or about August 18, 1904, under the laws of California and has its home office at Whittier, California. It took over from Simon J. Murphy certain oil properties among which was an oil and gas lease on certain land situated in California and owned by Domingo Bastanchury. The petitioner, through Edmund W. Bacon, one of its officers and its agent, purchased 2,240 acres of the land (hereinafter referred to as the Coyote properties) covered by such lease for $35 per acre, or $78,400, the deed to Murphy being dated December 15, 1904, and the deed from Murphy to petitioner being dated January 9, 1905. The purchase agreement involved also a cancellation of the oil and gas lease and the leasing of the surface rights to Bastanchury for 10 years for grazing purposes.

[31] At the time Bacon purchased property a well (hereinafter referred to as well No. 1) had been drilled to considerable depth under the lease, drilling operations had ceased, and the well had been capped. Drilling operations were resumed after the land was acquired by petitioner.

On August 26, 1918, after petitioner had leased the Coyote properties to the Standard Oil Company as set out below, Maria Bastanchury, as administratrix of Domingo Bastanchury, filed a complaint in the Superior Court of Los Angeles County against petitioner and Bacon. The complaint alleged that petitioner and Bacon had fraudulently misrepresented to the Bastanchurys that Well No. 1 was a dry hole, that indications of the presence of oil were destroyed or covered up to prevent the Bastanchurys from learning of their existence, and, that petitioner was about to abandon the lease. It was further alleged that no grounds for suspecting fraudulent misrepresentations had been discovered by the Bastanchurys until shortly before the filing of the complaint, that the misrepresentations had been made to induce complainants to sell the property for far less than its real worth; and that the Bastanchurys relied upon the misrepresentations in canceling the lease and selling the land.

The bill prayed that the defendants be required to account to plaintiff for all moneys or other things of value (in excess of $78,400, the price paid) obtained by them from their dealings with the Coyote properties, or from their dealings with the proceeds from the sale or operation thereof. It was also prayed that the defendants be required to assign and transfer to plaintiff all rights to receive such moneys [32] and things of value in the future; that a receiver be appointed to collect and receive from the then lessee, the Standard Oil Company, for the benefit of the plaintiff that which such lessee has become obligated to pay defendants as respects

such properties; and such other and further relief as the Court may deem meet and agreeable to equity, the premises considered, and for costs.

The answer filed late in 1918 denied all of the allegations set forth in the bill. The answer alleged that plaintiff, or her deceased husband, his heirs, devisees and personal representatives, had knowledge or notice by 1906 of all of the facts alleged to indicate fraud; that defendant Bacon had received any portions of the moneys or things of value derived from dealing with the land; that the land when purchased had a value in excess of $87,400. Other defenses set up in the answer include the statute of limitations (secs. 318, 319, 338, 343 and 353, Code of Civil Procedure of the State of California); laches; adverse possession and user since January of 1905; drilling and development of the property (with the knowledge and acquiescence of the Bastanchurys) by petitioner at heavy expense until the property was leased in 1913, which greatly enhanced the value thereof; transfers of stock of petitioners to purchasers for value without notice of the alleged fraud, etc., and alleged the relief prayed for would be unequitable and that plaintiff's remedy, if any, was for damages.

Legal expenses incurred during the year 1918 amounted to [33] $32,151.77. During the year 1919, further legal expenses totaled $170,877.24. During the latter year judgment in the amount of $1,200,000, as damages for the alleged wrongful acts, was entered against, and paid by, petitioner in such suit pursuant to an agreement between the par-

ties in compromise settlement. Petitioner, after investigation, had concluded that the action had no merit, but agreed to pay the amount agreed upon in compromise rather than continue the litigation, as the anticipated cost thereof would have equalled the amount of the settlement. Petitioner also deemed it advisable to avoid the disagreeable notoriety accompanying the suit. An instrument was executed by the Bastanchurys, including all the heirs and legatees, releasing petitioner, and all other persons or corporations claiming to own any interest in the land conveyed by the deed of December 15, 1904, from any further causes or actions for damages or rights on account of the alleged fraudulent acts.

The legal expenses incurred in 1918 were deducted as an expense in that year. Those incurred in 1919, together with the $1,200,000 paid in final settlement were deducted as expenses of that year. The deductions claimed were disallowed.

The respondent failed or refused to treat such legal expenses and the amount paid in compromise settlement as capital amortizable over the remaining life of the oil properties.

By an instrument dated December 1, 1913, petitioner leased certain oil properties, known as the Whittier and Coyote oil properties, to the [34] Standard Oil Company of California for 40 years, and by the same instrument, sold to that company specified personal property, including fixtures, appurtenances, tools, machinery and equipment, which were at that time located on or used in connection

with such oil properties. The instrument recited cash consideration of $10 (and other consideration, the receipt of which was acknowledged, which a stipulation shows to have totaled $1,500,000) and additional payments to be made from time to time. The due date, the actual date of payment and the amount of such additional payments may be tabulated as follows:

Due Date.	Date Paid.	Amount.
April 31, 1914	April 1, 1914	$1,000,000
March 31, 1915	March 1, 1915	250,000
June 31, 1915	June 1, 1915	250,000
Sept. 31, 1915	Sept. 1, 1915	250,000
Dec. 31, 1915	Dec. 31, 1915	250,000
June 31, 1916	July 13, 1916	500,000
Dec. 31, 1916	Dec. 1, 1916	500,000
Dec. 31, 1917	Dec. 1, 1917	500,000
Dec. 31, 1918	Dec. 1, 1918	500,000
		$4,000,000

The $1,500,000 paid down brings the total of such payments to $5,500.000. Petitioner also was to receive for the first five years a royalty of one-fourth of all oil produced in each year in excess of 730,000 barrels, and after the five-year period the royalty reserved amounted to one-fourth of the oil produced. The gas royalty agreed upon was a payment of two (2) cents for each one thousand cubic feet of gas saved and sold.

Of the $5,500,000 payments, the respondent determined that [35] $326,404.82 represented payment for the personal properties sold and the remainder

of $5,173,595.18 represented a bonus payment on the two properties. The respondent allocated such total bonus payment, $656,192.48 to the Whittier property and $4,517,402.70 to the Coyote property, and deducted the amount of such bonuses from the capital sums returnable through depletion in determining the unit of depletion sustained in 1919 and 1920, the years in controversy. Depletion deductions were based on March 1, 1913 value.

The gross production of the two properties in barrels of oil and the value thereof at the mouth of the wells from March 1, 1913, through the year 1915, is as follows:

During Period.	Coyote. Barrels.	Coyote. Amount.	Whittier. Barrels.	Whittier. Amount.
3–1–13 to 11–30–13	344,094.63	$292,480.44	221,178.85	$133,968.52
12–1–13 to 12–31–13	6,697.47	5,744.52	–	–
Cal. year 1914.	151,424.90	127,000.42	5.50	3.30
Cal. year 1915.	322,064.60	278,124.21	16,943.54	10,166.13
Totals	824,281.60	$703,349.59	238,127.89	$144,137.95

The depletion determined by the respondent to have been sustained by the petitioner from March 1, 1913, through the year 1915, is as follows:

Period 3–1–13 to 12–31–13.		1914	1915.	Total
Whittier	$74,048.17	$17,738.65	$38,021.95	$129,808.75
Coyote	183,327.41	135,572.08	306,749.76	625,649.25
Total	$257,375.58	$153,310.73	$344,771.69	$755,458.00

The respondent reduced petitioner's depletable base by the above amount of $755,458 in determining the depletion allowable for the years 1919 and 1920.

[36] The respondent determined that the amount of oil produced from petitioner's share of the Coyote Oil property during the years 1919 and 1920 was 1,644,897 barrels and 1,340,237 barrels, respectively.

The respondent determined the oil reserves in the Coyote property at December 31 of 1918 and 1919 amounted to 5,051,424 and 3,406,527 barrels, respectively.

OPINION.

SIEFKIN.—The issues raised in the first three allegations question the respondent's determination that the cost of the litigation in question and the payment made in compromise are neither deductible expenses nor capital cost which may be amortized over the remaining life of the properties. Apparently such determination was based on the conclusion that such expenditures represented personal expenses.

We think such conclusion unsound. The act complained of was committed, if at all, in the course of a business transaction. Kornhauser vs. United States, 276 U. S. 145, citing with approval an administrative ruling of the Bureau where expenses of a suit for malpractice were allowed as a business expense deduction by a physician. In this case the suit brought was in no sense a prosecution for a crime or an attempt to impose a penalty. The

only remedy sought was a restitution of the property, together with income derived therefrom in the *interim.* See Consolidated Mutual Oil Co., 2 B. T. A. 1067; and Frederick McLean Bugher et al., 9 B. T. A. 1155.

[37] We cannot agree, however, with petitioner's contention that the expenses and payment under discussion were deductible as business expenses or losses. The complaint filed in the suit alleged fraud and the relief prayed for was an accounting and that petitioner be required to assign and transfer to complainant all rights to receive moneys and things of value derived from the property in the future. That is, the prayer asks for restoration of the property and all past income therefrom in excess of the consideration paid.

It should be noted at this point that the action was brought to recover two distinct classes of assets. One such class of assets was the oil properties as they existed at the time the suit was instituted. Petitioner recognized that the complaint questioned its title to the property and in answer to the prayer for restoration asserted such relief to be inequitable, and that complainant's remedy, if any, was for damages. The other asset (the accumulated earnings resulting from petitioner's operation or production in years prior to the beginning of the suit) was no longer a part of such oil properties as they had been severed from the realty. They formed a distinct group of assets to which claim was made in the action. It should, therefore, be borne in mind that, though both claims grew out of the alleged

fraud, there were, nevertheless, two distinct claims asserted against two different groups of assets.

To the extent that the expenses and payment were incurred and made in defense of the claim against the oil properties they were capital expenditures. We have repeatedly held that the cost of defending title, [38] whether in the form of legal fees or compromise payments, is a capital expenditure representing additional cost of the property. Lincoln L. McCandless, 5 B. T. A. 1114; Gopher Granite Co., 5 B. T. A. 1216; Seletha O. Thompson, 9 B. T. A. 1342; Frederick McLean Bugher, *supra;* North American Oil Consolidated, 12 B. T. A. 68; Phoenix Development Co., 13 B. T. A. 414. The decisions in Kornhauser vs. United States, *supra,* and The Superheater Co., 12 B. T. A. 5, which are relied upon by the petitioner, are not in conflict with those cases. In the Superheater case the contemplated litigation grew out of an action of the board of directors, acting as such. The claim settled did not involve title. In the Kornhauser case the legal expenses were incurred to contest a claim against income received, differing fundamentally from the ordinary attack on title, even though the income in question consisted of shares of stock.

In view of such conclusion we must reject petitioner's contention that the total deductions claimed should be allowed. We cannot allow the total and it would be idle for us to further consider whether any part of such total (i. e., that portion allocable to the defense and settlement of the claim for accounting) is allowable as the record furnishes no

basis for the apportionment of the whole among the several claims defendant or settled.

The petitioner's contention that if the litigation and settlement costs are not deductible they must represent capital expenditures to be added to the amortizable capital value, must likewise be rejected. That portion of such costs which is properly allocable to the defense [39] and settlement of the accounting claim has nothing to do with title to the property or its future depletion. Assuming that such costs were capital expenditures they relate to a claim against assets or moneys severed from the oil properties. Frederick McLean Bugher et al., *supra.* Undoubtedly that portion of such costs which we have held allocable to defense and settlement of the claim against the properties should increase the amortizable capital value but we are again confronted with the fact that there is nothing in the record to permit a proper allocation to determine that amount. Accordingly, we must affirm the respondent's action on the points covered by the first three allegations of error.

The next error assigned is the reduction of depletable capital by the amount of the bonus received by the lessor as part consideration upon leasing the properties to the Standard Oil Company of California in December of 1913. The respondent determined that $5,173,595.18 of the $5,500,000 payments received represented such a bonus, and petitioner finds no fault with such allocation. Petitioner complains only of the admitted reduction of

the capital base for depletion purposes on account thereof.

The respondent's present contention as set forth in his brief is as follows:

> The Commissioner made an error of method in requiring the bonus of $656,192.48 on the Whittier property and the bonus of $4,517,595.18 on the Coyote property to be deducted as of December 1, 1913, from the capital sum returnable through depletion. On November 13, 1926, T. D. 3938 C. B. V. 2, p. 117, was promulgated amending Article 215 of Regulations 45 (1920 Edition) to read as follows:
>
> [40] 'Depletion—Adjustments of accounts based on bonus or advanced royalty.—(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.'
>
> While the Commissioner made an error of method in deducting from the depletion basis the whole amount of the bonuses as of December 1, 1913, it does not follow that the Commissioner's computation of the depletion basis is

incorrect. There is nothing in the record of this case to show what royalties were on December 1, 1913, expected to be received over the lives of the leases. It is entirely possible that in the interval between December 1, 1913, and December 31, 1918, royalties expected on December 1, 1913, to be received. As to this point the taxpayer must fail for lack of proof.

The respondent confesses error to the extent that he failed to follow the regulation. It remains for us to test the validity of the rule therein promulgated. In Nelson Land & Oil Co., 3 B. T. A. 315, we made it clear that, in our opinion, such a bonus received by a lessor was not a return of capital but is an advance rental or royalty and is taxable as income. That case was followed in R. H. Hazlett, 10 B. T. A. 332, and we are not cited and have been unable to find any authority to the contrary. See also Henry L. Berg, 6 B. T. A. 1287; John T. Burkett, 7 B. T. A. 560; D. R. McDonald, 7 B. T. A. 1078; and R. H. Hazlett, *supra,* in which we held that such bonuses were not gains derived from the sale of "capital assets" under the capital gain provisions of the 1921 Act.

[41] The bonus payment in the instant case was a part of the consideration paid for the lease. While expected production undoubtedly was considered in fixing the amount of the bonus, it is elementary under the laws governing such agreements that its payment did not, in anywise, depend upon, or relate to, production. The lessee's liability therefor was fixed by the terms of the contract. On the

other hand the operation of the principal of depletion depends upon exhaustion of resources through production—i. e., the recovery of capital through its conversion from the form of oil resources or reserves into marketable products or the equivalent received for such product. Under such principal the depletion allowance for the year or years of the bonus payments can only be measured by reference to the oil produced. If, as we have pointed out, the bonus is income, no part of which represents recovery of capital, it follows that any depletion allowance against such income is a departure from the depletion concept. The regulation relied on by the respondent is clearly such a departure. While it might in some cases at least produce a more equitable result the statutory allowance may not be so varied by administrative regulation.

It will be noted that the facts referred to by respondent in the last paragraph of the excerpt from his brief are essential only to the application of the rule laid down in the regulation. On the other hand the respondent admits that he reduced the depletable base by the amount of the bonus (a known quantity) and we have held as a matter of law that [42] no part of such bonus reduces such base. We can, on the facts presented, determine such action was erroneous. To correct such error we need only require the restoration of the amount subtracted, and it is so ordered.

The question raised by the last allegation was considered in Thompson Oil and Gas Company, 15 B.

T. A. 993, and decided adversely to the contention made by the petitioner herein.

Reviewed by the Board.

Judgment will be entered under Rule 50.

MILLIKEN did not participate.

LANSDON, PHILLIPS, GREEN and MURDOCK dissent.

Now, Feb. 20, 1931, the foregoing Findings of Fact and Opinion certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[43] United States Board of Tax Appeals.

DOCKET No. 14,440.

MURPHY OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

The Board having promulgated its opinion in the above-entitled proceeding on March 30, 1929, and the petitioner having duly submitted its notice of settlement and recomputation under rule 50, which was set down and called for hearing on January 15, 1930, and it appearing that said recomputa-

tion, showing no deficiencies for the years 1919 and 1920, was uncontested by the respondent, it is

ORDERED AND DECIDED: That there are no deficiencies for the years 1919 and 1920.

(Signed) LOGAN MORRIS,
Member, U. S. Board of Tax Appeals.

Entered Jan. 17, 1930.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Now, Feb. 20, 1931, the foregoing Decision certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

---

[44] Filed Jul. 15, 1930. United States Board of Tax Appeals.

United States Circuit Court of Appeals for the Ninth Circuit.

No. ——.

Term, 1930.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

against

ROBERT H. LUCAS, Commissioner of Internal Revenue,
Respondent.

PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The Murphy Oil Company in support of this, its petition, filed in pursuance of the provisions of Section 1001 of the Act of Congress approved February 26, 1926, entitled "The Revenue Act of 1926," as amended by Section 605 of the Act of Congress approved May 29, 1928, entitled "The Revenue Act of 1928," for the review of the decision of the United States Board of Tax Appeals promulgated March 30, 1929, a final order of determination having been entered January 17, 1930, respectfully shows to this Honorable Court as follows:

[45] I.

STATEMENT OF THE NATURE OF THE CONTROVERSY.

1. BRIEF STATEMENT OF FACTS.

(a) The petitioner was, during the years 1918 and 1919, and still is the owner of certain oil properties in the State of California, ordinarily known as the Whittier and Coyote fields. In connection with one of these fields, the Coyote field, certain litigation was instituted against petitioner in the year 1918 by Maria Bastanchury, the wife of Domingo Bastanchury, from whom petitioner had purchased

the property in 1904. Maria Bastanchury was administratrix with the will annexed of the estate of Domingo Bastanchury and her complaint was filed in the Superior Court, Los Angeles, California. Petitioner defended the suit and it was finally settled, after the petitioner had incurred legal expenses involving in 1918 $32,151.77 and in 1919 $170,877.24, for the sum of $1,200,000. Judgment for the last-mentioned sum was entered against petitioner under date of April 28, 1919. (Assignments of Error 1, 2 and 3, pages 8 and 9.)

(b) Under date of December 1, 1913, petitioner entered into an agreement bearing that date with the Standard Oil Company of California, under which agreement the last-mentioned corporation has since operated the Whittier and Coyote oil properties. Pursuant to the agreement mentioned, the Standard Oil Company paid to the petitioner a one-fourth royalty and a bonus of $5,173,595.18. (Decided by Board in favor of petitioner, page 6.)

[46] 2. STATEMENT OF PROCEEDINGS HERETOFORE HELD.

On April 24, 1926, the petitioner filed with the United States Board of Tax Appeals in pursuance of the provisions of the Revenue Act of 1926, its petition requesting the redetermination of a proposed deficiency in income and excess profits taxes for the calendar years 1919 and 1920 amounting to $398,400.53 ($76,740.20 for 1918 and $321,660.33 for 1919), as shown by the final notice of deficiency previously mailed by the respondent under date of

February 6, 1926. The petitioner subsequently duly filed with the United States Board of Tax Appeals an amended petition under date of April 3, 1928, and subsequently thereto under date of Sept. 20, 1928, duly filed with the United States Board of Tax Appeals a second amended petition as an amendment to and in lieu of the original and first amended petitions.

The petition as finally amended alleged that the petitioner was a corporation organized under the laws of California with its Home Office at Whittier, California, and also alleged that the Commissioner of Internal Revenue in determining the deficiency for the calendar years 1919 and 1920, set forth in his deficiency letter of February 6, 1926, committed errors as follows:

(1) In refusing to allow as a deduction from gross income in computing taxable net income for the year 1919 the sum of $1,370,877.24 paid in that year by petitioner as follows:

> $170,877.24 as legal expense in defending an action for an accounting relative to its Coyote Oil [47] property (the so-called Bastanchury Litigation).
>
> $1,200,000 in settlement of said suit for an accounting.

(2) In determining that the total of $1,370,877.24 paid as aforesaid together with the $32,901.34 paid in 1918 by petitioner as legal expenses in connection with the said suit for an accounting, should not be amortized as a capital expenditure over the remaining life of the Coyote Oil property, if it

were not an allowable deduction in computing taxable net income.

(3) In deducting from the petitioner's capital sum returnable through depletion of its Whittier and Coyote Oil properties to be used in determining the annual depletion allowances or deductions from gross income in computing net income for 1919 and 1920, the amounts respectively of $656,192.48 and $4,517,402.70 representing a bonus received by the petitioner on the leasing of the said oil properties in 1913, the result of said action by the Commissioner being to increase petitioner's taxable net income.

(4) In reducing the capital sum returnable through depletion of said Whittier and Coyote Oil properties to be used in determining the annual depletion allowances or deductions from gross income in computing net income for 1919 and 1920 by an amount alleged to represent depletion of said properties during the period from March 1, 1913, to December 31, 1915, on the basis of the value of said properties on March 1, 1913, and the subsequent cost thereof, whereas the said reduction should have been limited to the amount of depletion the petitioner was legally entitled to take under the income tax law in effect during said period from March 1, 1913, to December 31, 1915.

In short, the Commissioner's alleged errors were directed to a refusal to allow any part of the sums paid either as attorneys' fees or in settlement of the Bastanchury litigation either as a deduction from gross income in the year of payment or as a capital

item to be amortized over the remaining life of the properties in connection with which the payment was made. [48] The Commissioner also reduced the petitioner's capital sum returnable through depletion by the total sum of $5,173,595.18 paid to the company by the Standard Oil Company as a bonus, on the theory that the agreement of December 1, 1913, between the petitioner and the Standard Oil Company was not a lease, but conveyed title to the Standard Oil Company. The depletion allowable under the act of October 3, 1913, in effect from March 1, 1913, to December 31, 1915, was limited to 5% of the gross value at the well of the share of the taxpayer's oil produced during the year. The Commissioner, in determining the amount of depletion allowable to petitioner during the years 1919 and 1920, reduced the depletable base or capital sum returnable through depletion by the greater amount of depletion sustained rather than the limited amount deductible under the income tax act in effect as aforesaid.

On September 21, 1928, the respondent filed with the said United States Board of Tax Appeals its answer to the petition which answer admitted some of the more formal facts and denied a number of the other material facts alleged in the said petition. The answer denied all of the allegations of error asserted in the petitioner's petition to the Board of Tax Appeals.

The cause came on for hearing before the United States Board of Tax Appeals at Washington, D. C., on October 22, 1928. Thereafter on March 30, 1929,

the Board rendered its findings of fact in substantial accord with the facts alleged in the petition, together with an opinion in which it [49] was held as a matter of law that:

"1. Legal expenses and a payment in compromise of a suit alleging petitioner acquired oil properties by fraudulent means and seeking to recover the properties together with an accounting for profits obtained from dealings with such properties, were not personal expenses, nor were they deductible as business expenses, for that portion allocable to the defense of the claims against title was a capital expenditure. (See Allegation of Error 1 above.)

2. The claim for an accounting was a distinct claim involving a distinct group of assets and that portion of the expenses and compromise payment allocable to the defense and settlement of such claim, if a capital expenditure, has nothing to do with the oil properties and should not be added to the depletable capital account thereof, and, in the absence of evidence permitting a proper allocation of the expenses and payment between the two claims no allowance may be made as a business expense or as additional depletion. (See Allegation of Error 2 above.)

3. A cash bonus payment by the lessee for an oil and gas lease represents taxable income and having no relation to exhaustion of re-

sources does not reduce the depletable base of the lessor. (See Allegation of Error 3 above.)

4. The depletable base determining the depletion allowance under the 1918 act is reduced by the exhaustion actually sustained in prior years and not by the amount of the deductions allowable for prior years under prior Revenue Acts." (See Allegation of Error 4 above.)

In (1) and (2) above, the Board advanced the theory or principle that the Bastanchury suit involved two claims against two distinct classes of assets, (1) the Coyote properties themselves, and (2) the accumulated earnings resulting from petitioner's operation of or production from the properties in years prior to the suit, and that the amounts paid as legal expense and in settlement should be allocated in part to each claim. It was [50] held that there was no evidence furnishing a basis of apportionment between the two, and that therefore nothing could be allowed to petitioner either as a deduction in the years of payment or as capital to be amortized over the remaining life of the properties.

In (3) above, the Board decided in favor of the petitioner and in (4) above, it decided against the petitioner.

The final decision and order of redetermination of the Board of Tax Appeals entered January 17, 1930, in accordance with the foregoing opinion and decision of the Board of Tax Appeals resulted in the elimination of the deficiency of $398,400.53 asserted by the respondent in the sixty-day letter

from which petitioner took appeal to the Board of Tax Appeals.

II.

DESIGNATION OF COURT OF REVIEW.

The petitioner, being aggrieved by the said findings of fact, opinion and decision and order, and being a corporation with its principal place of business in the City of Whittier, California, desires a review thereof, in accordance with the provisions of the Revenue Act of 1926, as amended by the Revenue Act of 1928, by the United States Circuit Court of Appeals for the Ninth Circuit, within which Circuit is located the office of the Collector of Internal Revenue to which the said petitioner made its income and profits tax returns for the calendar years 1919 and 1920.

[51] III.

ASSIGNMENT OF ERRORS.

The petitioner, as a basis of review makes the following assignment of errors:

(1) The Board of Tax Appeals erred in holding that the payments of legal expense and settlement, totalling $1,370,877.24 made by the petitioner in connection with the Bastanchury litigation in the year 1919 did not constitute an allowable deduction of their entirety in that year.

(2) If the Board of Tax Appeals did not err as alleged in 1 above, it erred in failing to hold that the payments of $32,151.77 and $1,370,877.24 made by petitioner respectively in the years 1918

and 1919 in settlement of the Bastanchury litigation, and aggregating $1,403,029.01, constituted additional cost of petitioner's Coyote Oil properties to be amortized over the remaining life of the Coyote properties and allowed as a deduction from gross income in computing taxable net income for the calendar years 1919 and 1920.

(3) If the Board of Tax Appeals was correct in its holding that the payments of $32,151.77 and $1,370,877.24 made by petitioner respectively in the years 1918 and 1919 as legal fees in connection with and in settlement of the Bastanchury litigation related to claims against two distinct classes of assets, then (a) the Board erred in its finding that there was not sufficient evidence before it to permit an allocation of such payments between the two claims, and (b) if the evidence before the Board was insufficient to [52] provide a basis for the proper allocation to each of said claims of the aggregate sum paid, the Board erred in failing to set the case down for further hearing and production of such further evidence as might be necessary for such a determination.

(4). The Board of Tax Appeals erred in holding that the petitioner's depletable base for its oil properties should be reduced by the depletion sustained on the March 1, 1913, value that subsequent cost of said properties during the period March 1, 1913, to December 31, 1915, whereas, the Board should have held that petitioner's depletable base should be reduced only by the depletion which the petitioner was legally entitled to take as a de-

duction in determining its taxable income for the said period from March 1, 1913 to December 31, 1915.

WHEREFORE, your petitioner prays that this Honorable Court may review the said findings, opinion, decision and order of the Board of Tax Appeals, and reverse and set aside the same in so far as it relates to the assignments or allocations of error set forth above by petitioner; and the petitioner further prays that in the event that any issue in the case coming before this honorable court on this appeal other than those appealed by petitioner, is so decided by this court as to result in a deficiency against the petitioner the case may be remanded to the Board of Tax Appeals for the taking of further evidence upon the question as to that part of the Bastanchury payments which constituted an allowable deduction [53] in the year of payment and that part which should be added to the cost of petitioner's Coyote properties, or capital returnable through depletion; and petitioner further prays for such other and further relief as the Court may deem proper in the premises and for which your petitioner will ever pray.

RANDOLPH E. PAUL,
Attorney for the Taxpayer,
Shoreham Building,
Washington, D. C.
KENYON F. LEE,
Attorney for the Taxpayer,
Herman W. Hellman Bldg.,
Los Angeles, California.

THOMAS H. DEMPSEY,
Attorney for the Taxpayer,
508 Security Bldg.,
Los Angeles, California.

[54] City of Washington,
District of Columbia,—ss.

Personally appeared before me the subscriber a notary public, in and for the City of Washington, District of Columbia, Randolph E. Paul, who upon being duly sworn according to law, does depose and say that he is attorney for the petitioner above named and that as such he had authority to and did sign the foregoing petition; that he has read the same and that the facts set forth therein are true to the best of his knowledge and belief and that the said petition is filed in good faith.

(Signed) ESTHER W. MARSHMAN,
Notary Public, D. C.

Subscribed and sworn to before me this 12th day of July, 1930.

[Notarial Seal]

(Signed) ESTHER W. MARSHMAN,
Notary Public, Washington, D. C.

[55] Filed July 16, 1930. U. S. Board of Tax Appeals.

To the United States Board of Tax Appeals,
Washington, D. C.

DOCKET No. 14,440.

THE MURPHY OIL COMPANY,
Petitioner,

against

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

NOTICE.

To C. M. Charest, Esq., Bureau of Internal Revenue, Washington, D. C., Attorney for the Respondent.

Sir: PLEASE TAKE NOTICE that on the 15th day of July, 1930, the undersigned presented to this Board and filed with the Clerk thereof the petition of The Murphy Oil Company, a copy of which is annexed hereto, for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the final order and decision of the Board in the above-entitled proceeding entered upon the records of said Board on the 17th day of January, 1930.

Dated Washington, D. C., July 15, 1930.

RANDOLPH E. PAUL,
Attorney for the Petitioner,
Shoreham Building,
Washington, D. C.

Copy of the within notice and copy of petition for review is hereby accepted this 16th day of July, 1930.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Now, Feb. 20, 1931, the foregoing Petition for Review and Notice of Filing certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[56] Filed Jan. 31, 1931. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 14,440.

MURPHY OIL COMPANY,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PRAECIPE FOR TRANSCRIPT OF RECORD.

To the Clerk of the United States Board of Tax Appeals:

You are requested to prepare and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit a transcript of record in the above-entitled case and to include therein certified copies of the following documents:

1. The docket entries of proceedings before the Board.
2. Second amended petition of the Murphy Oil Company.
3. Answer of the Commissioner of Internal Revenue to second amended petition.
4. Findings of fact and opinion of the Board dated March 30, 1929.
5. Final decision of the Board dated January 17, 1930.

[57] 6. Petition for Review.

7. Notice of filing of petition for review and proof of service.
8. This praecipe.

The foregoing to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

RANDOLPH E. PAUL,
Attorney for Petitioner,
Shoreham Building,
Washington, D. C.

Dated January 30, 1931.

I, this 31st day of January, 1931, accept due personal service of a copy of the foregoing praecipe.

C. M. CHAREST,
Attorney for Respondent.

Now, Feb. 20, 1931, the foregoing Praecipe certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[Endorsed]: No. 6388. United States Circuit Court of Appeals for the Ninth Circuit. Murphy Oil Company, a Corporation, Petitioner, vs. David Burnet, Commissioner of Internal Revenue, Respondent. Transcript of Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed February 27, 1931.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6459

United States

Circuit Court of Appeals

For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

MURPHY OIL COMPANY, a Corporation,
Respondent.

Transcript of Record.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Parker Printing Company, 545 Sansome Street, San Francisco 1-22-31—60

INDEX TO THE PRINTED TRANSCRIPT OF RECORD.

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

KENYON F. LEE, ESQ.,
THOS. R. DEMPSEY, ESQ.,
ELMONT B. HAZARD, ESQ.,
GEO. E. HOLMES, ESQ.,
RANDOLPH E. PAUL, ESQ.,
CHAS. B. McINNIS, ESQ.,
J. B. HAVENS, ESQ.,

For Respondent:

JOHN D. FOLEY, ESQ.,
W. F. GIBBS, ESQ.

Docket No. 14440

MURPHY OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

Mr. Morris 11/9/29.

1926

Apr. 24—Petition received and filed.
May 5—Copy of petition served on Solicitor.
May 5—Notification of receipt mailed taxpayer.
June 24—Answer filed by Solicitor.

Aug. 4—Copy of answer served on taxpayer—assigned to General Calendar.

1927

Feb. 15—Notice of appearance of Elmont B. Hazard as counsel for taxpayer.

1928

Feb. 20—Hearing date set 4/19/28.

Apr. 3—Motion for leave to file amended petition, amendment tendered, filed by taxpayer.

Apr. 5—Hearing set on motion 4/11/28.

Apr. 5—Copy of motion and amendment served on General Counsel.

Apr. 11—Hearing had before Mr. Littleton on taxpayer's motion to amend—granted. Continued to May 16th.

Apr. 11—Ordered motion be granted; case stricken from 4/19/28 to May 16, 1928, entered.

Apr. 14—Answer filed by General Counsel. Copy served 4/19/28.

May 16—Hearing had before Mr. Sternhagen, continued 30 days. Stipulation pending.

May 16—Order of continuance to June 20, 1928 entered.

June 13—Motion to transfer to Reserve Calendar filed by taxpayer.

June 14—Motion granted.

Aug. 17—Motion to set down for hearing filed by General Counsel. Granted Aug. 22, 1928.

Aug. 28—Hearing set Oct. 22, 1928.

Sept. 20—Motion for leave to file second amended petition filed by taxpayer. Amendment tendered.

Sept. 21—Motion granted.

Sept. 22—Stipulation to take depositions filed.

Sept. 24—Copy of motion and amendment served on General Counsel.

Sept. 25—Answer to second amended petition filed by General Counsel. Copy served 9/27. [1*]

1928

Oct. 15—Depositions of Kenyon F. Lee filed (2). Notary served taxpayer. 10/16 copy served on General Counsel.

Oct. 22—Hearing had before Mr. Siefkin—submitted on stipulation. Taxpayer's brief due Dec. 20th.

Oct. 29—Transcript of hearing Oct. 22 filed.

Dec. 19—Motion for extension to Jan. 21, 1929 to file brief filed by taxpayer. Granted 12/20/28.

1929

Jan. 5—Brief filed by General Counsel.

Jan. 21—Brief filed by taxpayer.

Mar. 15—Motion to withdraw original exhibit and substitute copy filed by taxpayer. 3/18/29 granted.

Mar. 30—Findings of fact and opinion rendered—Mr. Siefkin. Judgment will be entered under Rule 50.

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*Page number appearing at the foot of page of original certified Transcript of Record.

Dec. 7—Notice of settlement filed by taxpayer. 12/11/29 copy served on General Counsel.

Dec. 10—Hearing set Jan. 8, 1930 on settlement.

1930

Jan. 8—Hearing had before Mr. Murdock, Division 3, on settlement Rule 50. Continued to Jan. 15, 1930.

Jan. 8—Order of continuance to Jan. 15, 1930 on settlement entered.

Jan. 15—Hearing had before Mr. Morris, Division 14, on settlement Rule 50. Assigned to Mr. Morris, Division 14, for order.

Jan. 17—Decision entered—Logan Morris, Division 14.

July 11—Petition for review to U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by General Counsel.

July 15—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by taxpayer.

July 16—Proof of service of taxpayer's petition for review filed.

July 17—Proof of service of General Counsel's petition for review filed. (Attorney).

July 28—Proof of service filed by General Counsel.

Sept. 9—Motion for extension to Oct. 31, 1930 to prepare and transmit record, filed by General Counsel.

Sept. 9—Order enlarging time to Oct. 31, 1930 for preparation of evidence and transmission and delivery of record entered.

Sept. 13—Motion for extension to Oct. 31, 1930 to file statement of evidence and certify record filed by taxpayer.

Sept. 15—Order enlarging time to Oct. 31, 1930 for preparation of evidence 9th Circuit, entered.

Oct. 31—Motion for extension to Jan. 31, 1931 to prepare and transmit record filed by General Counsel.

Oct. 31—Motion for extension to Jan. 31, 1931 to prepare and transmit record filed by taxpayer.

Oct. 31—Order enlarging time to Jan. 31, 1931 for petitioner to prepare and transmit record entered.

Oct. 31—Order enlarging time to Jan. 31, 1931 for Commissioner to prepare and transmit record entered.

1931

Jan. 31—Motion for extension to Feb. 28, 1931 to prepare statement and transmit record filed by taxpayer. [2]

Jan. 31—Praecipe with proof of service thereon filed by taxpayer.

Jan. 31—Motion for extension to Feb. 28, 1931 to prepare evidence and transmit record filed by General Counsel.

Jan. 31—Order enlarging time to Feb. 28, 1931 for preparation of evidence and delivery of record entered.

Jan. 31—Order enlarging time to Feb. 28, 1931 for preparation of evidence and transmission and delivery of record entered.

Feb. 28—Motion for extension to April 30, 1931 to prepare statement and transmit record filed by General Counsel.

Feb. 28—Order enlarging time to Mar. 25, 1931 for preparation of evidence and delivery of record entered.

Mar. 25—Praecipe filed by General Counsel.

Mar. 31—Proof of service of praecipe filed. [3]

[Endorsed]: Filed Apr. 24, 1926.

United States Board of Tax Appeals

Docket No. 14440

MURPHY OIL COMPANY,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated February 6th, 1926 and as a basis of such appeal sets forth the following:

1. The taxpayer is a corporation organized under the laws of the state of California, with its home office at Whittier, California.

2. The deficiency letter (a copy of which is attached hereto and made a part of this petition and marked Exhibit "A") was mailed to the taxpayer on February 6th, 1926. The 60 days within which to appeal granted by that deficiency letter was subsequently extended to April 26th, 1926, by the Revenue Act of 1926. [4]

3. The deficiencies asserted in the letter of February 1926 are income and excess-profits taxes for the calendar years 1919 and 1920 amounting to $76,740.20 and $321,660.33 respectively; these entire amounts are in controversy.

4. ASSIGNMENTS OF ERROR.

The determination of taxes contained in the said deficiency letter is based upon the following errors:

(a) The Commissioner has erred in refusing to allow as a deduction in computing net income for the year 1919 the sum of $170,877.24, paid in that year as legal expenses in defending an action against the taxpayer for an accounting, relative to a portion of its oil lands, to wit., its Coyote properties.

(b) The Commissioner has erred in refusing to allow as a deduction in computing net income for the year 1919 the sum of $1,200,000.00 paid in that year as a compromise of a suit for an accounting against the taxpayer relative to its Coyote properties.

(c) The Commissioner has erred in refusing to increase the basis for computing the depletion of the Coyote properties by adding to the basis then

unextinguished by depletion the sum of $1,370,-877.24 representing legal expenses in the amount of $170,877.24 paid in 1919 and the sum [5] of $1,200,000.00 paid in 1919 as a compromise of a suit for an accounting against the taxpayer relative to its Coyote properties.

5. STATEMENT OF FACTS.

The facts on which the taxpayer relies as the basis of this appeal are as follows:

(a) The Murphy Oil Company purchased certain property designated as Coyote Hills from one Domingo Bastanchury by deed dated December 15th, 1904.

(b) Prior to the purchase of the said property the taxpayer and its predecessors in title had leased the property from the said Domingo Bastanchury.

(c) On or about August 26th, 1919, Maria Bastanchury, the widow of the said Domingo Bastanchury and administratrix with the will annexed of his estate, filed an appeal in the Superior Court of Los Angeles County, California, against the Murphy Oil Company and against the individual who in 1904 managed the Company's affairs and properties, claiming that the Murphy Oil Company had discovered oil on the field before it negotiated with him for the purchase of the property.

(d) The Murphy Oil Company employed a number of counsel and took active steps to defend itself.

(e) In its answer to the complaint of the said Maria Bastanchury as administratrix with the will

annexed of the estate of Domingo Bastanchury, the Murphy Oil Company denied [6] all material allegations in the said complaint.

(f) While the case was being prepared for trial and in the month of April, 1919, it came to the attention of the Murphy Oil Company that the said Maria Bastanchury was willing to consider a compromise.

(g) After a long conference on the part of the officials of the taxpayer corporation, it was decided, in order to minimize the extensive costs of the suit and to avoid as much as possible the unpleasant and disagreeable notoriety accompanying the suit, to compromise if a satisfactory compromise could be made.

(h) After long negotiations through a banker in Los Angeles, the two parties to the suit agreed upon a compromise whereby the said Maria Bastanchury withdrew her request for an accounting and agreed to accept the sum of $1,200,000.00 in full payment of any damages that the estate of the said Domingo Bastanchury may have suffered as a result of any action of the Murphy Oil Company.

(i) Accordingly a judgment was entered against the Murphy Oil Company for $1,200,000.00 under date of April 28th, 1919, which judgment was paid immediately thereafter.

(j) The taxpayer paid to its attorneys and as other legal expenses in connection with the above mentioned suit the sum of $170,877.24. The taxpayer in its accounts treated the entire sum of $1,370,-

877.24 as a loss during the calendar year 1919. [7]

(k) The Commissioner reversed the taxpayer's action in treating the above amount as a loss and refused to allow it as a deduction in computing net income for the year 1919.

(l) The Commissioner has determined that on January 1st, 1919, the unextinguished capital sum of the Coyote property of the Murphy Oil Company for purposes of depletion was $6,050,021.63 and that the recoverable oil reserves on the same date were 5,044,673 barrels.

(m) The production from the taxpayer's Coyote property for 1919 was 1,644,897 barrels and was for the year 1920 1,340,237 barrels.

PRAYER FOR RELIEF.

1. WHEREFORE, the taxpayer respectfully prays that the Board may decide that the sums of $1,200,000.00 and $170,877.24 are properly deductible from gross income in computing net income for the year 1919.

2. If the Board should decide that the above amounts are not deductible in computing net income for the year 1919, the taxpayer further prays that the Board may decide that the said amounts should be added to the capital sum of its Coyote Oil property as of January 1st, 1919 and amortized over the remaining life of the property on the basis of the oil produced.

3. The taxpayer further prays that the Board may dis- [8] allow the entire deficiency for both of the years 1919 and 1920.

4. The taxpayer further prays that the Board may duly hear and decide this appeal, and order the taxpayer's income and excess-profits tax liability recomputed accordingly.

GEO. E. HOLMES,
Attorney for the Taxpayer,
15 William Street,
New York City. [9]

State of Michigan,
County of Wayne.—ss.

William H. Murphy being duly sworn deposes and says that he is President of the MURPHY OIL COMPANY, Whittier, California, the taxpayer named in the foregoing petition; that as such he is duly authorized to verify the foregoing petition; that he has read the said petition, and is familiar with the statements therein contained; and that the facts set forth therein are true to the best of his knowledge, information and belief.

WILLIAM H. MURPHY,

Sworn to before me this 22nd day of April, 1926.

(Seal) WALTER P. CLARK,
Notary Public, Wayne County, Michigan.
My Commission expires Apr. 3, 1929. [10]

TAXPAYER'S EXHIBIT "A"

Treasury Department,
Washington.
Feb. 6, 1926.

Office of
Commissioner of Internal Revenue.
IT:CA:2555-8-60D.
Murphy Oil Company,
Whittier, California.
Sirs:

The determination of your income tax liability for the years 1919 and 1920, pursuant to an examination of your books of account and records as set forth in office letter dated December 12, 1925, disclosed a deficiency in tax amounting to $398,400.53, as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal contesting in whole or in part the correctness of this determination. Any such appeal must be addressed to the United States Board of Tax Appeals, Washington, D. C., and must be mailed in time to reach that Board within the 60-day period.

Where a taxpayer has been given an opportunity to appeal to the Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made,

no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the enclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of It:CA:2555-8-60D. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

MF/3 Respectfully,

D. H. BLAIR,
Commissioner.

By Assistant to the Commissioner.

Inclosures:
Statements
Agreement—Form A
Form 882. [11]

Feb. 6, 1926.

STATEMENT

IT:CA:2555-8-60D

In re: Murphy Oil Company,
Whittier, California.

	Deficiency in Tax
1919	$ 76,740.20
1920	321,660.33
Total	$398,400.53

1919

Net income, books		$910,609.09
Additions:		
Income taxes disallowed in accordance with Article 131, Regulations 45,		354,316.20
Donations disallowed in accordance with Article 562, Regulations 45		1,039.16
Legal costs defending title to all lands in accordance with Article 293, Regulations 45,		170,877.24
Settlement of suit attaching title to oil land in accordance with Article 293, Regulations 45		1,200,000.00
Excessive depreciation in accordance with revised schedules		41.09
Total		$2,636,882.78
Deduct:		
Depletion restored excluded from income account the net adjustment due to revising reserves	$ 231,082.20	
Depletion allowed in accordance with engineer's report	2,072,660.49	2,303,742.69
Net income corrected		$ 333,140.09

Statement
Murphy Oil Company

INVESTED CAPITAL

Capital stock		2,000,000.00
Less:		
Stock discount in accordance with Section 326, Revenue Act of 1918		150,000.00
Capital stock		$1,850,000.00
Surplus - books	$313,433.28	
Plus:		
Adjustments, corrected balance sheet	150,651.22	
Surplus, corrected balance sheet	$464,084.50	464,084.50
Total		$2,314,084.50
1918 tax prorated in accordance with Article 845, Regulations 45	$ 69,364.70	
Dividends prorated in accordance with Article 858, Regulations 45	712,986.30	782,351.00
Balance		$1,531,733.50
Deduction:		
Inadmissibles in accordance with Article 852, Regulations 45		28,474.93
Invested capital - corrected		$1,503,258.57

EXCESS PROFITS CREDIT

8% of invested capital	$120,260.69
Exemption	3,000.00
Total credit	$123,260.69

Net Income	Credit	Balance	Rate	Tax
$300,651.71	$123,260.69	$177,391.02	20%	$35,478.20
32,488.38		32,488.38	40%	12,995.35
Excess profits tax				$48,473.55

MF/3 [13]

Statement

Murphy Oil Co.

Excess profits tax			$48,473.55
Net income		$333,140.09	
Less:			
Profits tax	$48,473.55		
Exemption	2,000.00	50,473.55	
Taxable at 10%		$ 282,666.54	28,266.65
Total tax			$76,740.20
Tax previously assessed			none
Deficiency in tax			$76,740.20

1920

Net income - books	$2,881,680.14
Add:	
Donations disallowed in accordance with Article 562, Regulations 45	1,246.59
Depletion claimed	102,692.94
Excessive depreciation in accordance with revised schedule	2,930.84
Total	$2,988,550.51
Deduct:	
1918 income tax credited back, due to the same not paid	$ 354,316.20
Depletion allowed in accordance with engineer's report	1,689,645.13
Net income corrected	$ 944,589.18

INVESTED CAPITAL

Capital stock		$2,000,000.00
Less:		
Stock discount		150,000.00
Capital stock		$1,850,000.00
MF/3 [14]		

Statement
Murphy Oil Co.

Amount brought forward		$1,850,000.00
Deficit - books	$175,957.63	
Add:		
Adjustments, corrected balance sheets	972,087.68	
Surplus, corrected balance sheets		796,130.05
Total		$2,646,130.05
Deduct:		
1919 taxes prorated in accordance with Article 845, Regulations 45	$ 32,342.16	
Dividends prorated in accordance with Article 858, Regulations 45	347,049.17	379,391.33
Balance		$2,266,738.72
Deduction:		
Inadmissibles in accordance with Article 853, Regulations 45		42,320.01
Invested capital corrected		$2,224,418.71

EXCESS PROFITS CREDIT

8% of invested capital	$177,953.50
Exemption	3,000.00
Total credit	$180,953.50

Net Income	Credit	Balance	Rate	Tax
$444,883.74	$180,953.50	$263,930.24	20%	$52,786.05
499,705.44		499,705.44	40%	199,882.18
$944,589.18				$252,668.23
Net income		$944,589.18		
Profits tax	$252,668.23			
Exemption	2,000.00	254,668.23		
Taxable at 10%		$689,920.95		
Taxable at 10%				68,992.10
Total tax				$321,660.33

MF/3 [15]

Statement
Murphy Oil Co.

Amount brought forward	$321,660.33
Tax previously assessed	none
Deficiency in tax	$321,660.33

BALANCE SHEET - DECEMBER 31, 1918

Assets	Books	Additions	Reductions	Amended
Cash	$ 86,250.87			$ 86,250.87
Notes Receivable	5,432.29			5,432.29
Accts. "	270,730.31			270,730.31
Sundry debtors	538,206.10			538,206.10
Farm products	5,141.15	$ 684.00(2)		5,825.15
Land	72,426.19			72,426.19
Agricultural land	370,285.06	161,700.70(3)		531,985.76
Equipment	441,331.50			441,331.50
Stock	46,252.21			46,252.21
Bonds	70,830.00			70,830.00
Discount capital stock	——	160,000.00(4)		150,000.00
Taxes overpaid	——	73,001.70(5)		73,001.70

Assets	Books	Additions		Reductions	Amended
Oil lands	1,319,200.70		(6)	1,046,207.84	262,992.86
	$3,226,086.38				$2,555,264.94
Accrued salaries	833.37				833.37
Accrued payroll	4,955.97				4,955.97
Accounts payable	19,197.70				19,197.70
Reserve for depreciation	63,986.95		(7)	2,206.45	66,193.40
Reserve for depletion	823,679.11	823,679.11	(8)		—
Capital stock	2,000,000.00				2,000,000.00
Surplus	313,433.28				464,084.50
	$3,226,086.38				$2,555,264.94

2. To adjust in accordance with books.
3. To set up corrected values of agricultural land.
4. To set up Stock Discount.
5. To set up tax overpayment in accordance with Article 845, Regulations 45.
6. To adjust in accordance with engineer's report.
7. To correct reserve in accordance with revised schedule.
8. Adjusted in asset account.

MF/3 [16]

Statement

Murphy Oil Co. BALANCE SHEET - DECEMBER 31, 1919

Assets	Books	Additions		Reductions	Amended
Cash	$84,747.89				$ 84,747.89
Notes Receivable	2,268.87				2,268.87
Accts. "	187,675.13				187,675.13
Sundry debtors	30,623.59				30,623.59
Inventories:					
Packing House	19,714.20				19,714.20
Farm products	1,449.87	684.00	(2)		2,133.87
Land	72,306.19				72,306.19
Agricultural land	370,285.06	161,700.70	(3)		531,985.76
Oil lands	1,319,200.70		(4)	193,908.53	1,125,292.17
Equipment	489,142.28				489,142.28
Stocks	50,309.15				50,309.15
Bonds	90,880.00				90,880.00
Cancelled checks	42.00				42.00
Discount on capital stock		150,000.00	(5)		150,000.00
Taxes overpaid		263,179.96	(6)		263,179.96
Oil land, March 1, 1913, appreciation	33,673,817.83		(7)	33,673,817.83	
	$36,392,462.76				$3,100,301.06

Liabilities	Books	Additions		Reductions	Amended
Accrued salaries	$ 833.37				833.37
Accrued payroll	4,965.16				4,965.16
Accounts payable	202,147.11				202,147.11
Reserve for depreciation	94,060.01		(8)	2,165.36	96,225.37
Reserve for depletion on cost	592,596.91	592,596.91	(9)		—
Reserve for depletion on appreciation	13,554,444.43		(10)	13,554,444.43	—
Capital stock	2,000,000.00				2,000,000.00
Earned surplus	—				796,130.05
Deficit	175,957.63				—
Surplus by appreciation of oil land	20,119,373.40				—
	$36,392,462.76				$3,100,301.06

MF/3 [17]

Statement Murphy Oil Co.

2 and 3. As previously explained for the balance sheet - December 31, 1918.
4. Adjusted in accordance with engineer's report.
5 and 6. As adjusted in previous year.
7. Eliminated as balance sheet revised on cost.
8. As explained in previous year.
9. Adjusted through asset account.
10 and 11. Eliminated balance adjusted on cost.

BALANCE SHEET - DECEMBER 31, 1920

Assets	Books	Additions	Reductions	Amended
Cash	$ 85,600.96			$ 85,600.96
Notes Receivable	2,193.95			2,193.95
Accts. "	245,109.65			245,109.65
Sundry debtors	206,741.57		$177,158.10	29,556.47
Inventories:				
Packing	25,331.85			25,331.85
Farm products	3,539.45	684.00		4,223.45
Land	72,306.19			72,306.19
Agricultural land	370,285.06	161,700.70		531,985.76
Oil lands	1,319,200.70		608,757.17	710,443.53
Equipment	517,468.99			517,468.99
Stocks	50,309.15			50,309.15
Bonds	380,880.00			380,880.00
Appreciation—				
Oil lands	33,673,817.83		33,673,817.83	—
Taxes overpaid	—	9,281.66		9,281.66
Discount on capital stock	—	150,000.00		150,000.00
	$36,952,758.35			$2,814,691.61

MF/3 [18]

Statement Murphy Oil Co.

BALANCE SHEET - DECEMBER 31, 1920 (Continued)

Liabilities	Books	Additions	Reductions	Amended
Accrued salaries	$ 1,000.00			$ 1,000.00
Accrued payroll	4,880.54			4,880.54
Accounts payable	20,382.10			20,382.10
Reserve for depreciation	131,665.52	$ 765.48		130,900.04
Reserve for depletion cost	695,289.85	695,289.85		—
Reserve for depletion on appreciation	16,133,709.03	16,133,709.03		—
Capital stock	2,000,000.00			2,000,000.00
Earned surplus	425,722.51			657,528.93
Surplus by appreciation	17,540,108.80	17,540,108.80		—
	$36,952,758.35			$2,814,691.61

Adjustments are as explained in the prior balance sheets

ANALYSIS OF SURPLUS

Surplus, December 31, 1918		$ 464,084.50
Net income		333,140.09
Realized appreciation		1,564,082.56
		$2,361,307.15
Dividends	$1,400,000.00	
1918 taxes	354,316.20	
	1,039.16	1,755,355.36
Balance		$ 605,951.79
Overpayment taxes		190,178.26
Surplus, December 31, 1919		$ 796,130.05
Net income, 1920		944,589.18
Realized appreciation		1,274,796.49
		$3,015,515.72
Dividends	$2,280,000.00	
Donations	1,246.59	2,281,246.59
Balance		$ 734,269.13
Taxes corrected		76,740.20
Surplus, December 31, 1920		$ 657,528.93

MF/3 [19]

Statement

Murphy Oil Co.

Depletion has been allowed in accordance with the attached revised schedule, based upon a ruling by the Bureau that the judgment and legal costs represent a part of the cost of the property and not additional capital items to be added to the March 1, 1913, value in accordance with Section 326 of the Revenue Act of 1918.

You are advised that your protest submitted by your representatives and received in this office January 12, 1925, has been carefully considered and it is deemed that a conference is not advisable at this time.

Relative to items one and two you are informed that the Commissioner has not acquiesced in these decisions and consequently cannot be allowed. Item three has been adjusted in accordance with your briefs.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district and remittance should then be made to him.

Enclosure:
Revised depletion
schedule
MF/3 [20]

[Endorsed]: Filed Apr. 3, 1928.

Granted by Order of April 11, 1928.

(Title of Court and Cause.)

MOTION FOR LEAVE TO FILE AMENDED PETITION.

Now comes the petitioner, by its attorney, GEORGE E. HOLMES, and asks leave to file the attached Amended Petition in the above-named proceeding upon the following grounds:

1. Said Amended Petition sets forth more accurately and more clearly the facts upon which the petitioner relies in support of its contentions and the petitioner believes the more explicit allegations of fact and assignments of error contained in the

Amended Petition will greatly aid this Board in the understanding and proper determination of this case.

2. Further, the Amended Petition contains a new assignment of error (IV (a)) which was not included in the original petition and which petitioner believes to be a good and valid defense against the deficiency found by the Commissioner.

3. As a further and final reason for the granting of this Motion, the Amended Petition contains a request that the taxes be computed under the provisions of Section 327 and [21] Section 328 of the Revenue Act of 1918; a request for such Special Relief was not contained in the original petition. In view of the decision of the United States Supreme Court in the Oesterlein Machine Company case sustaining the right of this Board to subpoena comparatives from the Commissioner of Internal Revenue and the promulgation of Rule 62 by this Board to facilitate the application to pending appeals of the right so granted, the petitioner believes that it is in a position to present evidence which will justify the computation of its taxes under Sections 327 and 328 of the Revenue Act of 1918.

WHEREFORE, Petitioner prays that the Amended Petition be received.

GEORGE E. HOLMES,
Attorney for Petitioner.
15 William Street,
New York, N. Y. [22]

[Endorsed]: Filed April 11, 1928.

(Title of Court and Cause.)

AMENDED PETITION.

The above named petitioner has previously filed a petition with this Board under date of April 24, 1926, appealing from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated February 6, 1926. This amended petition is hereby filed as an amendment to the original petition. As a basis for its appeal, the petitioner sets forth the following:

I. The taxpayer is a corporation organized under the laws of the State of California, with its home office at Whittier, California.

II. The deficiency letter from which this appeal is made was mailed to the Petitioner on February 6, 1926. The sixty day period within which to appeal to this Board as granted in that deficiency letter was subsequently extended to April 26, [23] 1926, by the Revenue Act of 1926. A copy of the deficiency letter from which this appeal is made is attached hereto marked Exhibit #1. A copy of the preceding thirty day letter dated December 12, 1925 is also attached hereto, marked Exhibit #2. A copy of a previous sixty day letter dated October 6, 1925 covering the same taxable years is also attached hereto and marked Exhibit #3.

III. The deficiencies asserted in the letter of February 6, 1926 are for income and excess profits taxes for the calendar years 1919 and 1920 and are

in the amounts of $76,740.20 and $321,660.33, respectively. The total amounts of these deficiencies are in controversy.

ASSIGNMENTS OF ERROR.

IV. The determination of the deficiencies set forth in the said deficiency letter is based upon the following errors:

(a) The Commissioner has erred in aserting against the petitioner the deficiencies in question after having previously determined deficiencies for the same taxable years and having failed to assess the deficiencies previously determined in the sixty day letter dated October 6, 1925.

(b) The Commissioner has erred in deducting from invested capital for the years 1919 and 1920 an amount of $150,000 alleged to represent discount on capital stock.

(c) The Commissioner has erred in deducting from invested capital for the years 1919 and 1920 an amount of [24] $1,364,015.39 representing the cost to the petitioner corporation of oil lands acquired at the date of its organization in exchange for capital stock of the petitioner corporation.

(d) The Commissioner has erred in failing to determine that the petitioner corporation was entitled to a paid-in-surplus on the basis of the oil lands acquired at the time of organization in exchange for its capital stock.

(e) The Commissioner has erred in failing to determine that the petitioner's invested capital and taxable income were abnormal for the taxable years

1919 and 1920 and that petitioner's excess profits tax liability should be computed under the provisions of Section 327 and 328 of the Revenue Act of 1918.

(f) The Commissioner has erred in refusing to allow as a deduction from net income for the year 1919 the sum of $170,877.24 paid in that year as legal expenses in defending an action against the petitioner for an accounting relative to a portion of its oil properties, to wit, its Coyote Oil Properties.

(g) The Commissioner has erred in refusing to allow as a deduction from net income for the year 1919 the sum of $1,200,000 paid in that year in settlement of a suit for an accounting brought against the petitioner relative to its Coyote Oil Properties.

(h) The Commissioner has further erred in determining that the amounts of $170,877.24 and the $1,200,000 paid by the petitioner in connection with a suit for an accounting relative [25] to its Coyote Oil Properties constitute capital expenditures and at the same time failing to determine that such amounts should be amortized over the remaining life of the said Coyote Oil Properties.

STATEMENT OF FACTS.

V. The facts on which the petitioner relies as the basis of this appeal are as follows:

(1) The Commissioner determined the petitioner's tax liability for the years 1919 and 1920 and under the provisions of Section 274 of the

Revenue Act of 1924 forwarded to the petitioner corporation a sixty day deficiency letter dated October 6, 1925, determining a deficiency of $63,738.38 for the year 1919 and a deficiency of $296,485.30 for the year 1920. A copy of this deficiency letter is attached hereto, marked Exhibit #3.

(2) The petitioner did not appeal from the determination set forth in the deficiency letter of October 6, 1925.

(3) The Commissioner has not assessed the deficiencies determined in the sixty day letter of October 6, 1925.

(4) Subsequent to the expiration of the sixty day period allowed by the letter of October 6, 1925 for appeal to this Board, to wit, on December 12, 1925, the Commissioner forwarded to the petitioner corporation a so-called thirty day letter determining a deficiency for the year 1919 in the amount [26] of $76,740.20 and a deficiency for the year 1920 in the amount of $321,528.94.

(5) Subsequently, to wit, February 6, 1926, the Commissioner forwarded to the petitioner corporation another deficiency notice determining a deficiency of $76,740.20 for the year 1919 and a deficiency of $321,660.33 for the year 1920.

(6) The Murphy Oil Company was incorporated on or about October 11, 1904 under the laws of the State of California.

(7) The Commissioner determined that upon its incorporation in 1904, the petitioner corporation issued its entire capital stock with a par value of

$2,000,000 to Simon J. Murphy for a fee title to 2,500 acres of land located near the town of Whittier in the State of California containing the petitioner's Whittier Oil Property, together with personal property of the nature and value as set forth below:

Imprest Cash Fund	$ 30.60
Cash in First National Bank, Whittier	10,468.82
Accounts Receivable	25,493.90
Development A. C. S. J. M. 17 Wells	153,156.81
Leaseholds	1,925.00
Buildings	5,425.86
Cottages (6)	4,400.00
Engines, Boilers, Pumps & Fittings	8,343.00
Other Machinery & Tools	606.30
Well Tools	9,906.40
Derricks & Equipment	10,000.00
Cables—Wire, etc.	2,840.00
Casing, Tubing, etc.	14,675.90
Tanks, Drums, etc.	27,508.00
Pipe Lines & Fittings	12,300.00
Tracks and Sidings	1,084.41
Horses	2,555.00
Wagons, Harness, etc.	975.00
	[27]
Telephone Equipment	650.00
Office Furniture & Fixtures	455.00
Oil in Storage (85000 Bbls)	51,000.00
Farm Products in Storage	6,200.00
Total	$350,000.00

(8) The Commissioner determined that the surface value of the said 2,500 acres of land acquired by the Petitioner upon its incorporation was $320,-374.37.

(9) The amount of capital stock which petitioner corporation issued for its Whittier oil property at the date of organization was $1,329,625.43 representing the difference between the total capital stock issued to Simon J. Murphy in the amount of $2,000,000 and the value of the surface land of $320,374.37 together with the value of the personal property acquired in the amount of $350,000.00

(10) The petitioner corporation did not dispose of any part of its capital stock at a discount.

(11) No additional capital stock was issued or sold by the petitioner corporation between the date of organization and December 31, 1920.

(12) The said 2,500 acres of land acquired by the petitioner upon its incorporation included approximately 500 acres of proven oil land. This oil field is hereinafter referred to as petitioner's Whittier oil property.

(13) Petitioner's Whittier oil property contained seventeen producing oil wells at the date of acquisition and had [28] been producing oil for many years prior to 1904.

(14) The market price of oil of the grade produced by the petitioner's Whittier oil property was 80¢ per barrel on or about the date of petitioner's incorporation.

(15) The Commissioner determined that the value of the petitioner's Whittier oil property on

March 1, 1913 was $1,450,207.08 and that the amount of oil recoverable from the said property at that date was 5,983,443 barrels.

(16) The above mentioned value of $1,450,-207.08 determined by the Commissioner as of March 1, 1913 was based upon a market price of oil of 35¢ a barrel at that time.

(17) The entire area of the petitioner's Whittier oil property on which the above mentioned March 1, 1913 value was based was proven oil bearing territory at the time of acquisition by the petitioner corporation.

(18) The petitioner corporation extracted from its Whittier oil property an amount in excess of 1,800,000 barrels of oil between the date of acquisition and March 1, 1913.

(19) The Commissioner reduced the petitioner's earned surplus by the total amount of $1,364,015.39 in computing invested capital for the taxable years 1919 and 1920.

(20) This action of the Commissioner in reducing petitioner's earned surplus by the amount of $1,364,015.39 resulted in the exclusion from invested capital of the total amount paid by petitioner for its Whittier oil property together with an amount of $34,389.96 representing capital expenditures made [29] by petitioner on its Whittier oil property subsequent to the acquisition of the said property.

(21) Petitioner's Whittier oil property had a fair market value greatly in excess of $1,329,625.43 at the date of acquisition.

(22) Simon J. Murphy was in control of the said Whittier oil property prior to its acquisition by the petitioner corporation and was in control of the petitioner corporation immediately after it acquired the said property.

(23) The petitioner corporation purchased from one Domingo Bastanchury by deed dated December 15, 1904, 2,240 acres of land in the Coyote Hills of California for a price of $35 per acre.

(24) The total price paid by the petitioner corporation for the said 2,240 acres of land amounted to $78,400.

(25) Subsequent to the purchase of the said land and prior to March 1, 1913, the petitioner corporation discovered that approximately 840 acres of said land contained oil bearing sands.

(26) Prior to March 1, 1913 this said property, which is hereinafter referred to as Petitioner's Coyote Property, proved to be one of the most valuable oil properties in the State of California.

(27) The Commissioner determined that the March 1, 1913 value of petitioner's Coyote property was $15,710,899.52.

(28) This valuation was based upon a market price [30] of oil of 35¢ per barrel.

(29) On or about August 26, 1918, Maria Bastanchury, the widow of the said Domingo Bastanchury and administratrix with the will annexed of his estate, filed a complaint in the Superior Court of Los Angeles County, California, against the Murphy Oil Company and the individual who in 1904 man-

aged the company's affairs and properties, for an accounting of the profits received by the Murphy Oil Company from the said Coyote property.

(30) The Murphy Oil Company employed a number of counsel and took active steps to defend itself.

(31) In its answer to the complaint of the said Maria Bastanchury, as administratrix with the will annexed of the Estate of Domingo Bastanchury, the Murphy Oil Company denied all the material allegations in the said complaint and vigorously opposed the complainant's prayer for an accounting of the profits received from the said Coyote property.

(32) While the case was being prepared for trial, to wit: in the month of April, 1919, it came to the attention of the Murphy Oil Company that the said Maria Bastanchury was willing to consider a settlement.

(33) After a long conference on the part of the officials of the petitioner corporation, it was decided, in order to minimize the extensive costs of the suit and to avoid as much as possible the disagreeable notoriety accompanying the suit, to settle, if a satisfactory settlement could be made. [31]

(34) After long negotiations through a banker in Los Angeles, the two parties to the suit agreed upon a settlement whereby the said Maria Bastanchury withdrew her request for an accounting and agreed to accept the sum of $1,200,000 in full settlement of any damages that the Estate of Domingo Bastanchury may have suffered as a result of any action of the Murphy Oil Company.

(35) Accordingly a judgment was entered against the Murphy Oil Company for $1,200,000 under date of April 28, 1919, which judgment was paid immediately thereafter.

(36) The petitioner paid during the year 1919 fees and other legal expenses in connection with the above-mentioned litigation in the amount of $170,-877.24.

(37) The petitioner in its accounts treated the entire amount of $1,370,877.24 as a loss during the calendar year 1919.

(38) The Commissioner reversed the petitioner's action in treating the above amount as a loss and refused to allow any part of the said amount as a deduction in computing net income for the year 1919.

(39) The Commissioner further refused to amortize the said payment of $1,370,877.24 over the remaining life of the Coyote oil property.

(40) The Commissioner determined that the petitioner's share of oil reserve in the Coyote property amounted to 5,044,673 [32] barrels as of December 31, 1918.

(41) The Commissioner determined that the amount of oil produced from the petitioner's share of the Coyote oil property during the year 1919 was 1,644,897 barrels.

(42) The Commissioner determined that the petitioner's share of the oil reserves in the Coyote property amounted to 3,399,776 barrels as of December 31, 1919.

(43) The Commissioner determined that the oil produced from petitioner's share of the Coyote

oil property during the year 1920 amounted to 1,340,237 barrels. [33]

PRAYERS FOR RELIEF.

The petitioner prays that this Board may determine that no part of the deficiencies determined in the letter of February 6, 1926, should be assessed for the reason that the Commissioner has failed to assess the deficiencies alleged in the letter of October 6, 1925, for the same taxable years.

Petitioner further prays that this Board may determine that petitioner's invested capital for the taxable years 1919 and 1920 should be increased by an amount of $150,000 representing the alleged discount on capital stock, the amount of $1,364,015.39 representing the cost to the petitioner of its Whittier Oil Property and an amount of $1,000,000 representing paid-in-surplus.

Petitioner further prays that this Board may determine that petitioner's income and invested capital were abnormal for the taxable years 1919 and 1920 and that petitioner's excess profits tax liability should be computed under the provisions of Sections 327 and 328 of the Revenue Act of 1918.

Petitioner further prays that this Board may determine that the amount of $1,370,877.24 paid by petitioner in connection with an action for an accounting constitutes an allowable deduction from taxable income for the year 1919, or that if the said amount constitutes a capital expenditure, the said amount should be amortized over the remaining life of petitioner's Coyote Oil Property on the

basis of a number of barrels of recoverable oil [34] in the said property at December 31, 1918.

Petitioner further prays that this Board may duly hear and determine this appeal and reduce petitioner's taxable income by such other deductions to which petitioner is entitled under the Revenue Act of 1918.

(signed) GEO. E. HOLMES,
(signed) VALENTINE B. HAVENS,
(signed) CHAS. B. McINNIS,
Attorneys for Taxpayer,
15 William Street,
New York City.

ELMONT B. HAZARD,
1039 Woodward Building,
Washington, D. C. [35]

State of Michigan,
County of Wayne.—ss.

William H. Murphy being duly sworn, deposes and says that he is William H. Murphy, President of the Murphy Oil Company of Whittier, California, the taxpayer named in the foregoing petition; that he has read the said petition and that the facts set forth therein are true to the best of his knowledge, information and belief.

(signed) WILLIAM H. MURPHY.

Sworn to before me this 2nd day of April, 1928.

[Notarial Seal] WALTER P. CLARK,
Notary Public, Wayne Co., Michigan.
My Commission Expires Apr. 3, 1929. [36]

[Endorsed]: Filed Sep. 20, 1928.
Granted Sep. 21, 1928.
(signed) B. H. LITTLETON,
Member U. S. Board of Tax Appeals.

(Title of Court and Cause.)

MOTION FOR PERMISSION TO FILE SECOND AMENDED PETITION.

Comes now the petitioner in the above entitled cause, by its Attorneys, George E. Holmes and Charles B. McInnis, and moves that it be permitted to file the attached petition in lieu of and as an amendment to the original and amended petitions previously filed with this Board.

This request is made for the reason that new facts have been discovered subsequent to the filing of the last petition which materially change petitioner's defense against the deficiency asserted by the Commissioner.

GEO. E. HOLMES,
Geo. E. Holmes,
15 William Street,
New York, N. Y.
CHAS. B. McINNIS,
Chas. B. McInnis,
15 William Street,
New York, N. Y.

[37]

[Endorsed]: Filed Sept. 21, 1928.

(Title of Court and Cause.)

SECOND AMENDED PETITION.

The above named petitioner filed a petition with this Board under date of April 24, 1926, appealing from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter, dated February 6, 1926. Subsequently this petitioner filed an amended petition, under date of April 3, 1928. This second amended petition is hereby filed as an amendment to the original petition and first amended petition. As a basis for its appeal, the petitioner sets forth the following:

I. The petitioner is a corporation organized under the laws of the State of California, with its home office at Whittier, California.

II. The deficiency letter from which this appeal is made was mailed to the petitioner on February 6, 1926. The sixty day period within which to appeal to this Board, as granted in that deficiency letter, was subsequently extended to April 26, 1926, by the Revenue Act of 1926. A copy [38] of the deficiency letter from which this appeal is made is attached hereto, marked Exhibit No. 1.

III. The deficiencies asserted in the letter of February 6, 1926 are for income and excess profits taxes for the calendar years 1919 and 1920 and are in the amounts of $76,740.20 and $321,660.33, respectively. The total amounts of these deficiencies are in controversy.

ASSIGNMENTS OF ERROR.

IV. The determination of the deficiencies set forth in the said deficiency letter is based upon the following errors:

(a) The Commissioner erred in refusing to allow as a deduction from net income for the year 1919 the sum of $170,877.24 paid in that year as legal expenses in defending an action against the petitioner for an accounting relative to a portion of its oil properties, to wit, its Coyote Oil Property.

(b) The Commissioner erred in refusing to allow, as a deduction from net income for the year 1919, the sum of $1,200,000 paid in that year in settlement of a suit for an accounting brought against the petitioner relative to its Coyote Oil Property.

(c) The Commissioner further erred in determining that the amounts of $170,877.24 and $1,200,000 paid by the petitioner during the year 1919 and the amount of $32,901.34 paid by the petitioner during the year 1918, in connection with a suit for an accounting relative to its Coyote Oil Property, constitute capital expenditures, and at the same time failing to determine that such amounts should be amortized over the remaining life of the said Coyote Oil property.

(d) The Commissioner erred in deducting from the capital sum returnable through depletion of the petitioner's [39] Whittier Oil property, an amount of $656,192.48 representing a bonus re-

ceived by the petitioner upon the leasing of the said oil property, in computing the amount of depletion sustained by the petitioner in connection with the said Whittier Oil property for the calendar years 1919 and 1920.

(e) The Commissioner erred in deducting from the capital sum returnable through depletion of the petitioner's Coyote Oil property, an amount of $4,517,402.70, representing a bonus received by the petitioner upon the leasing of the said oil property, in computing the amount of depletion sustained by the petitioner in connection with the said Coyote Oil property for the calendar years 1919 and 1920.

(f) The Commissioner erred in reducing petitioner's depletable base for both the Whittier and Coyote Oil properties by an amount alleged to represent depletion sustained on the March 1, 1913 value and subsequent cost of the said properties during the period from March 1, 1913 to December 31, 1915 whereas he should have reduced petitioner's depletable base by the amount of depletion which petitioner was legally entitled to take as a deduction in determining its taxable income for the said period from March 1, 1913 to December 31, 1915.

STATEMENT OF FACTS.

V. The facts upon which the petitioner relies as a basis of this appeal are as follows:

(1) The Murphy Oil Company was incorporated on or about August 18, 1904, under the laws of the State of California.

(2) The petitioner corporation, through its agents, purchased from one Domingo Bastanchury by deed dated December 15, 1904, 2,240 acres of land in Orange County, California, at a price of $35 per acre. [40]

(3) The total price paid by the petitioner corporation for the said 2,240 acres of land in Orange County, California, amounted to $79,400.

(4) Subsequent to the purchase of the said land and prior to March 1, 1913, the petitioner corporation discovered that approximately 840 acres of said land contained valuable oil bearing sands.

(5) On or about August 26, 1918, Maria Bastanchury, the widow of the said Domingo Bastanchury and administratrix with the will annexed of his estate, filed a complaint in the Superior Court of Los Angeles County, California, against the Murphy Oil Company and the individual who in 1904 managed the company's affairs and properties, for an accounting of the profits received by the Murphy Oil Company from the said Coyote property.

(6) The Murphy Oil Company employed a number of counsel and took active steps to defend itself.

(7) In its answer to the complaint of the said Maria Bastanchury as administratrix with the will annexed of the Estate of Domingo Bastanchury, the Murphy Oil Company denied all the material allegations in the said complaint and vigorously opposed the complainant's prayer for an accounting of the profits received from the said Coyote property.

(8) While the case was being prepared for trial, to wit, in the month of April, 1919, it came to the attention of the Murphy Oil Company that said Maria Bastanchury was willing to consider a settlement.

(9) After a long conference on the part of the officials of the Murphy Oil Company, it was decided, in order to minimize the extensive costs of the suit and to avoid as much as possible the disagreeable notoriety accompanying the suit, to settle, if a satisfactory settlement could be made. [41]

(10) After long negotiations through a banker in Los Angeles, the two parties to the suit agreed upon a settlement whereby the said Maria Bastanchury withdrew her request for an accounting and agreed to accept the sum of $1,200,000, in full settlement of any damages that the Estate of Domingo Bastanchury may have suffered as a result of any action of the Murphy Oil Company.

(11) Accordingly a judgment was entered against the Murphy Oil Company for damages in the amount of $1,200,000, under date of April 28, 1919, which judgment was paid immediately thereafter.

(12) The petitioner corporation paid during the year 1918 legal fees and other expenses in connection with the above mentioned litigation in the amount of $32,901.34.

(13) The petitioner corporation during the year 1919 paid legal fees and other legal expenses in connection with the above mentioned litigation in the amount of $170,877.24.

(14) The petitioner corporation, in its accounts, treated the amount of $32,901.34, paid during the year 1918 in connection with the above mentioned litigation, as a deductable expense in computing its taxable income for that year.

(15) The Commissioner reversed the petitioner's action and refused to allow the amount of $32,901.34 as a deduction in computing the petitioner's taxable income for the year 1918.

(16) The Commissioner failed to amortize the said amount of $32,901.34, paid during the year 1918 in connection with the above mentioned litigation, over the remaining life of the petitioner's Coyote Oil property.

(17) The petitioner in its accounts treated the amount of $1,370,877.24, paid during the year 1919 in connection [42] with the above mentioned litigation, as a loss during the calendar year 1919.

(18) The Commissioner reversed the petitioner's action in treating the above mentioned amount as a loss and refused to allow any part of the said amount as a deduction in computing taxable net income for the year 1919.

(19) The Commissioner further refused to amortize the said payment of $1,370,877.24, over the remaining life of the petitioner's Coyote Oil property.

(20) The Commissioner determined that petitioner's share of oil reserves in the Coyote Oil property at December 31, 1918 amounted to 5,044,673 barrels.

(21) The Commissioner determined that the amount of oil produced from the petitioner's share of the Coyote Oil properfy during the year 1919 was 1,644,897 barrels.

(22) The Commissioner determined that the petitioner's share of the oil reserves in the Coyote Oil Property at December 31, 1919 amounted to 3,399,776 barrels.

(23) The Commissioner determined that the oil produced from petitioner's share of the Coyote Oil property during the year 1920 amounted to 1,340,237 barrels.

(24) The petitioner leased to the Standard Oil Company, under date of December 1, 1913, its Whittier Oil property and its Coyote Oil property for a one-fourth royalty and a bonus of $5,500,000.

(25) The Commissioner determined that $326,-404.82 of the bonus represented payment for physical property and that the remaining amount of $5,173,595.18 represented a bonus on the two oil properties.

(26) The Commissioner further determined that $656,192.48 of the said amount of $5,173,595.18 represented a bonus on petitioner's Whittier Oil property and that the [43] remaining amount of $4,517,402.70 represented a bonus on petitioner's Coyote Oil property.

(27) The Commissioner deducted from the capital sum returnable through depletion of petitioner's Whittier Oil property, the said amount of $656,192.48 representing the bonus applicable to

the said Whittier Oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil produced from the Whittier Oil property for the years 1919 and 1920.

(28) The Commissioner deducted from the capital sum returnable through depletion of petitioner's Coyote Oil property, the said amount of $4,517,-402.70 representing the bonus applicable to the said Coyote Oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil produced from the Coyote Oil property for the years 1919 and 1920.

(29) The Commissioner determined that the depletion sustained by the petitioner on its Whittier and Coyote Oil properties during the period from March 1, 1913 to December 31, 1915 was as follows:

Year	Depletion sustained on March 1, 1913 value and subsequent cost.
1913	$257,375.58
1914	153,310.73
1915	344,771.69
Total	$755,458.00 [44]

(30) The Commissioner reduced petitioner's depletable base by the above amount of $755,458.00 in determining the amount of depletion allowable for the years 1919 and 1920.

(31) The gross value at the well of all of the petitioner's share of oil produced from its Whittier and Coyote Oil properties during the period from March 1, 1913 to December 31, 1915, amounted to $878,531.23.

(32) Under subdivision G (b) of the Revenue Act of 1913, approved October 3, 1913, the maximum amount of depletion which petitioner was legally entitled to deduct in computing its taxable net income for the period March 1, 1913 to December 31, 1915, was five percent of the gross value at the well of its share of the oil produced during the said period.

(33) Five percent of the gross value of petitioner's total share of oil produced from its Whittier and Coyote properties during the period from March 1, 1913 to December 31, 1915 amounted to $43,926.56. The difference between this amount and the amount of depletion alleged to have been sustained on the March 1, 1913 value and subsequent costs, or $711,531.44, represents the amount by which petitioner's depletable base for the two oil properties has been erroneously reduced in determining the amount of depletion allowable for the years 1919 and 1920. [45]

PRAYERS FOR RELIEF.

The petitioner prays that this Board may determine that the amount of $170,877.24 representing legal expenses paid by the petitioner during the year 1919 in connection with an action for an accounting relative to petitioner's Coyote Oil property constitutes an allowable deduction for the year 1919.

The petitioner further prays that this Board may determine that the amount of $1,200,000 repre-

senting damages paid during the year 1919 in connection with an accounting relative to petitioner's Coyote Oil property constitutes an allowable deduction for the year 1919.

The petitioner further prays that if this Board determine that the above named payments represent capital expenditures, it may determine that the said payments in the total amount of $1,370,877.24 together with the amount of $32,901.34 representing legal expenses paid during the year 1918 in connection with an action for an accounting relative to petitioner's Coyote Oil property, should be amortized over the remaining life of petitioner's Coyote Oil property on the basis of the number of barrels of recoverable oil in said property at December 31, 1918.

The petitioner further prays that this Board may determine that the capital sum returnable through depletion of petitioner's Whittier Oil property and Coyote Oil property should not be reduced by the amounts of $656,192.48 and $4,517,402.70 respectively, in determining the unit of depletion sustained by petitioner on oil produced from the said property during the years 1919 and 1920.

The petitioner further prays that this Board may determine that the depletable base of petitioner's Whittier and Coyote Oil properties should be reduced only by the de- [46] pletion legally allowable as a deduction from petitioner's taxable income for the period March 1, 1913 to December 31, 1915 in lieu of the depletion determined by the Commis-

sioner to have been sustained on the March 1, 1913 value and subsequent costs.

The petitioner further prays that this Board may duly hear and determine this appeal and reduce petitioner's taxable income by any other deduction to which petitioner is entitled under the Revenue Act of 1918 or subsequent revenue acts.

(Signed) GEO. E. HOLMES,
(Signed) RANDOLPH E. PAUL,
(Signed) CHARLES B. McINNIS,
Attorneys for Petitioner,
15 William Street,
New York, N. Y.
(Signed) THOMAS R. DEMPSEY,
Attorney for Petitioner,
508 Security Bldg.,
Los Angeles, California.
(Signed) ELMONT B. HAZARD,
Attorney for Petitioner,
1039 Woodward Bldg.,
Washington, D. C.
(Signed) BRADNER W. LEE, JR.,
(Signed) KENYON F. LEE,
Attorneys for Petitioner,
Herman W. Hellman Bldg.,
Los Angeles, California.

[47]

State of California,
County of Los Angeles.—ss.

Geo. E. Foley being duly sworn, deposes and says that he is 2nd Vice Pres. of the Murphy Oil Com-

pany of Whittier, California, the taxpayer named in the foregoing petition; that he has read the said petition and that the facts set forth therein are true to the best of his knowledge, information and belief.

(Signed) GEO. E. FOLEY.

Sworn to before me this 25th day of Aug., 1928.

SEAL

(Signed) TEMPERANCE R. BAILY,
Notary Public.

In and for the County of Los Angeles,
State of California. [48]

[Endorsed]: Filed Sept. 25, 1928.

(Title of Court and Cause.)

ANSWER TO SECOND AMENDED PETITION.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to second amended petition of the above-named taxpayer admits and denies as follows:

I, II, III. Admits the allegations in paragraphs I, II and III.

V, (1) Admits the allegations in paragraph V, (1).

V, (2), (3), (4), (5), (6), (7), (8), (9), (10), (11), (12), (13). For lack of information upon which to base a belief, denies the allegations in paragraphs V, (2), (3), (4), (5), (6), (7), (8), (9), (10), (11), (12) and (13).

V, (14), (15) Does not regard as material and therefore denies the allegations in paragraph*g* V, (14) and (15).

V, (16) Admits that the Commissioner failed to amortize the amount of $32,901.34 over the remaining life of the petitioner's Coyote oil property. Denies the remaining allegations in paragraph V, (16).

V, (17) Admits that the petitioner treated the amount of $1,370,877.24 as a loss during the calendar year 1919 in arriving at the net income reported on its income and profits tax return for the year 1919. Denies the remaining allegations in paragraph V, (17).

V, (18) Admits the allegations in paragraph V, (18).

V, (19) Admits that the Commissioner did not amortize the amount of [49] $1,370,877.24 over the remaining life of the petitioner's Coyote oil property. Denies the remaining allegations in paragraph V, (19).

V, (20) Denies the allegations in paragraph V, (20) and says that in arriving at the deficiency shown in the 60-day letter dated February 6, 1926, the Commissioner determined that the petitioner's share of oil reserves in the Coyote oil property at December 31, 1918 amounted to 5,051,424 barrels and not 5,044,673 barrels as alleged.

V, (21) Admits the allegations in paragraph V, (21).

V, (22) Denies the allegations in paragraph V, (22), and says that in arriving at the deficiency

shown in the 60-day letter dated February 6, 1926, the Commissioner determined that the petitioner's share of the oil reserves in the Coyote oil property at December 31, 1919 amounted to 3,406,527 barrels and not 3,399,776 barrels as alleged.

V, (23) Admits the allegations in paragraph V, (23).

V, (24) For lack of information upon which to base a belief, denies the allegations in paragraph V, (24).

V, (25) Admits that the Commissioner determined that $326,404.82 of the alleged bonus represented an alleged payment for physical property and that the remaining amount of $5,173,595.18 represented an alleged bonus on the two oil properties. Denies the remaining allegations in paragraph V, (25).

V, (26) Admits that the Commissioner further determined that $656,192.48 of the said amount of $5,173,595.18 represented an alleged bonus on the petitioner's Whittier oil property and that the remaining amount of $4,517,402.70 represented an alleged bonus on the petitioner's Coyote oil property. Denies the remaining allegations in paragraph V, (26). [50]

V, (27) Admits that the Commissioner deducted from the capital sum returnable through depletion of the petitioner's Whittier oil property, the said amount of $656,192.48 representing the so-called bonus applicable to the said Whittier oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil procured from

the Whittier oil property for the years 1919 and 1920. Denies the remaining allegations in paragraph V, (27).

V, (28) Admits that the Commissioner deducted from the capital sum returnable through depletion of the petitioner's Coyote oil property the said amount of $4,517,402.70 representing the so-called bonus applicable to the said Coyote oil property, in determining the unit of depletion sustained by the petitioner on the amount of oil produced from the Coyote oil property for the years 1919 and 1920. Denies the remaining allegations in paragraph V, (28).

V, (29), (30) Admits the allegations in paragraphs V, (29) and (30).

V, (31), (32), (33) Denies the allegations in paragraphs V, (31), (32) and (33).

Denies generally and specifically each and every allegation in taxpayer's second amended petition not hereinbefore expressly admitted, qualified or denied.

WHEREFORE, it is prayed that the petition be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN D. Foley,
Special Attorney,
Bureau of Internal Revenue.
jdf/9/21/28 [51]

[Endorsed]: Filed Oct. 22, 1928.

(Title of Court and Cause.)

STIPULATION.

It is hereby stipulated and agreed by and between the parties hereto by their respective counsel:

I.

That Domingo Bastanchury by deed dated December 15, 1904 conveyed to Edmund Bacon two thousand two hundred forty (2,240) acres of land located in Orange County, California, at a price of $35.00 per acre; that thereafter and on or about January 9, 1905, Edmund Bacon conveyed by deed the said property to the Murphy Oil Company; that attached hereto and marked Exhibits A1 and A2 are copies of the deeds herein referred to.

II.

That the total price paid by the Murphy Oil Company for the lands referred to in paragraph I hereof amounted to $78,400.00.

III.

That on or about August 26, 1918 Maria Bastanchury, the widow of Domingo Bastanchury and administratrix with the will annexed of his estate, filed a complaint in the Superior Court of Los Angeles County, California, against the Murphy Oil Company and Edmund Bacon; that thereafter and in due course of time the Murphy Oil Company filed its answer; that subsequent thereto and pursuant

to negotiations had between the parties, said suit was settled; that attached hereto and marked Exhibits B1 to B10 are copies of the papers in the action above referred to:

B1—Complaint. [52]

B2—Summons.

B3—Answer of Defendants.

B4—Consent to Judgment.

B5—Judgment for Plaintiff.

B6—Satisfaction of Judgment.

B7—Order authorizing settlement and compromise of title in Superior Court of the County of Orange, California, in the matter of the Estate of Domingo Bastanchury, Deceased.

B8—Petition of Maria Bastanchury, Administratrix with the Will Annexed of Domingo Bastanchury, in the Superior Court of Orange County, California, for an order authorizing her to compromise the claim of said Estate against the Murphy Oil Company, et al, and settle litigation.

B9—Release dated April 26, 1919 signed by Maria Bastanchury and children.

B10—Receipt and Agreement to Satisfy Judgment acknowledged April 29, 1919 by Maria Bastanchury as administratrix, and signed by the attorneys for the plaintiff in said action.

IV

That subsequent to the entry of the judgment herein referred to said Murphy Oil Company, during the year 1919 paid the total sum of $1,200,000.00

in satisfaction thereof; that during the year 1919 the Murphy Oil Company paid the sum of $170,-877.24 representing legal fees and other legal expenses in connection with the defense of said suit; that during the year 1918 the Murphy Oil Company paid the sum of $32,901.34 representing legal fees in connection with the defense of said action; that attached hereto and marked Exhibit C is a photostatic copy of the entry referring to the [53] said $32,901.34; that attached hereto and marked Exhibit D is a photostatic copy of the entry made on the books of the Murphy Oil Company relating to the sum of $170,877.24; that attached hereto and marked Exhibit E is a photostatic copy of the entry made by the Murphy Oil Company in its books relating to the said sum of $1,200,000.00; that the Murphy Oil Company, as indicated by the photostatic copy attached hereto, treated said payments as expenses and took them as a deduction in its income and profits tax return for the respective years 1918 and 1919; that the Commissioner, in examining the said returns, disallowed said items as deductions.

V

The Murphy Oil Company under date of December 1, 1913, leased the Whittier Oil property and its Coyote Oil property to the Standard Oil Company, a California corporation, a true copy of said lease being attached hereto and marked Exhibit F; that pursuant to the terms of said lease herein referred to the Murphy Oil Company in addition to the roy-

alties received in oil, received from the Standard Oil Company of California the sum of $5,500,000.00 in installments as follows:

Dec. 31, 1913	$1,500,000.00
April 1, 1914	$1,000,000.00
March 1, 1915	250,000.00
June 4, 1915	250,000.00
Dec. 1, 1915	250,000.00
Dec. 31, 1915	250,000.00
July 13, 1916	500,000.00
Dec. 1, 1916	500,000.00
Dec. 1, 1917	500,000.00
Dec. 1, 1918	500,000.00
Total	$5,500,000.00

A. GEORGE BOUCHARD,
Special Attorney Bureau of Int. Rev.
Attorney for Commissioner.
A. CALDER MACKAY,
Attorney for Petitioner [54]

State of California,
County of Orange.—ss.

I, J. M. Backs, County Clerk and ex-officio clerk of the Superior Court in and for said County (the same being a Court of Record, having a seal), do hereby certify that Justine Whitney is, and was at the time of signing the within instrument, an acting County Recorder in and for said County, duly qualified, and full faith and credit are due to all his official acts as such.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of the Superior Court, at my office, this 25th day of September, 1928.

[Seal] J. M. BACKS,
County Clerk.

I, James L. Allen, Esq., Judge of the Superior Court of the State of California, within and for the County of Orange, hereby certify that J. M. Backs, whose signature is affixed to the above certificate, is the County Clerk of the County of Orange, State of California, and ex-officio Clerk of the Superior Court in and for said County and is the proper certifying officer of said Court, and has by law the custody of the seal, and all the records, books, documents and papers of or appertaining to said Court, and said certificate is in due form as used in this State.

IN WITNESS WHEREOF, I have hereunto set my hand this 25th day of September, 1928 in the year of our Lord nineteen hundred and Twenty-eight.

JAMES L. ALLEN,
Judge of the Superior Court.

State of California,
County of Orange,—ss.

I, J. M. Backs, County Clerk of the County of Orange, State of California, and ex-officio Clerk of

the Superior Court thereof, which is a court of record having a seal, hereby certify that Hon. James L. Allen, whose name is subscribed to the above certificate of qualification, was at the date thereof a Judge of the Superior Court of the State of California, in and for said County, duly elected and qualified, that he is authorized to make such certificates; that full faith and credit are due to his official acts as such Judge. I further certify that I verily believe that the signature attached to said certificate is genuine and that said certificate is executed according to the laws of the State of California.

Witness my hand and the official seal of the Superior Court of Orange County, hereto affixed this 25th day of September, 1928.

[Seal] J. M. BACKS,
County Clerk and ex-officio Clerk of said Court.

[55]

THIS INDENTURE, made the fifteenth day of December, in the year of our Lord one thousand nine hundred and four, Between Domingo Bastanchury and Maria Bastanchury, his wife, of Fullerton, California, the parties of the first part, and Edmund W. Bacon of Whittier, California, the party of the second part,

WITNESSETH: That the said parties of the first part, for and in consideration of the sum of One Thousand ($1000.00) Dollars in Gold Coin of

the United States of America to them in hand paid by the said party of the second part, the receipt whereof is hereby acknowledged, do by these presents grant, bargain and sell, convey and confirm unto the said party of the second part and to his heirs and assigns forever, all that certain real property situate in the County of Orange, State of California, and particularly described as follows:

All of Sections Eighteen (18) and Twenty (20); South Half (S½) and South Half (S½) of North Half (N½) of Section Seventeen (17) and North Half (N½) and Southeast Quarter (SE¼) of Section Nineteen (19), Township Three (3) South, Range Ten (10) West, S. B. M.

TOGETHER with all and singular the tenements, hereditaments and appurtenances thereunto belonging or in anywise appertaining, and the reversion and reversions, remainder and remainders, rents, issues and profits thereof.

TO HAVE AND TO HOLD all and singular the said premises, together with the appurtenances, unto the said party of the second part and to his heirs and assigns forever.

IN WITNESS WHEREOF the said parties of the first part have hereunto set their hands and seals the day and year in this indenture first above written.

[Seal] DOMINGO BASTANCHURY,
By MARIA BASTANCHURY,
his atty. in fact.

Signed, sealed and delivered in the presence of

[Seal] MARIA BASTANCHURY,

State of California,
County of Los Angeles.—ss.

On this 16th day of December, in the year of our Lord one thousand nine hundred and four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, State of [56] California, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, wife of Domingo Bastanchury, known to me to be the person described in and whose name is subscribed to the foregoing instrument, and she acknowledged to me that she executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for the County of Los Angeles, State of California.

State of California,
County of Los Angeles.—ss.

On this 16th day of December, in the year one thousand nine hundred and four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, known to me to be the person whose name is subscribed to the within instrument as the attorney in fact of Domingo Bastanchury, and acknowledged to me that she subscribed the name of Domingo Bastanchury thereunto as principal, and her own as attorney in fact.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for said Los Angeles County, State of California.

A full, true and correct copy of the original recorded at the request of Grantee the 4th day of January, A. D. 1904, at 32 min. past 2 o'clock p. m. George E. Peters, County Recorder, By W. S. Gregg, Deputy. [57]

State of California,
County of Orange,—ss.

I HEREBY CERTIFY The foregoing to be a full, true and correct copy of the instrument appearing recorded in Book No. 104 of Deeds, page 318 Records of Orange County, and that I have carefully compared the same with the original record.

IN WITNESS WHEREOF I have hereunto set my hand and affixed my official seal this 24 day of September, 1928.

(Seal) JUSTINE WHITNEY,
County Recorder [58]

State of California,
County of Orange,—ss

I. J. M. Backs, County Clerk and ex-officio clerk of the Superior Court in and for said County (the same being a Court of Record, having a seal, do

hereby certify that Justine Whitney is, and was at the time of signing the within instrument, an acting County Recorder in and for said County, duly qualified, and full faith and credit are due to all his official acts as such.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of the Superior Court, at my office, this 25th day of September, 1928.

[Seal] J. M. BACKS,
County Clerk.

I, James L. Allen, Esq., Judge of the Superior Court of the State of California, within and for the County of Orange, hereby certify that J. M. Backs, whose signature is affixed to the above certificate, is the County Clerk of the County of Orange, State of California, and ex-officio Clerk of the Superior Court in and for said County and is the proper certifying officer of said Court, and has by law the custody of the seal, and all the records, books, documents and papers of or appertaining to said Court, and said certificate is in due form as used in this State.

IN WITNESS WHEREOF, I have hereunto set my hand this 25th day of September, 1928 in the year of our Lord nineteen hundred and Twenty-eight.

JAMES L. ALLEN,
Judge of the Superior Court.

State of California,
County of Orange,—ss.

I, J. M. Backs, County Clerk of the County of Orange, State of California, and ex-officio Clerk of the Superior Court thereof, which is a court of record having a seal, hereby certify that Hon. James L. Allen, whose name is subscribed to the above certificate of qualification, was at the date thereof a Judge of the Superior Court of the State of California, in and for said County, duly elected and qualified, that he is authorized to make such certificates; that full faith and credit are due to his official acts as such Judge. I further certify that I verily believe that the signature attached to said certificate is genuine and that said certificate is executed according to the laws of the State of California.

WITNESS my hand and the official seal of the Superior Court of Orange County, hereto affixed this 25th day of September, 1928.

[Seal] J. M. BACKS,
County Clerk and ex-officio Clerk of said Court [59]

THIS INDENTURE, Made the 9th day of January, in the year of our Lord one thousand nine hundred and five, between Edmund W. Bacon and Anna Bacon, his wife, of Whittier, California, the parties of the first part, and Murphy Oil Com-

pany, a corporation organized and existing under the laws of the State of California, having its principal place of business at Whittier, California, the party of the second part,

WITNESSETH: That the said parties of the first part for and in consideration of the sum of Ten Dollars in Gold Coin of the United States of America to them in hand paid by the said party of the second part, the receipt whereof is hereby acknowledged, do by these presents grant, bargain and sell, convey and confirm unto the said party of the second part, and to its successors and assigns, forever, all of that certain real property situate in the County of Orange, State of California, and particularly described as follows:

In the Ranchos La Habra, Los Coyotes and San Juan Cajon de Santa Ana, all of Sections Eighteen (18) and Twenty (20); the South Half (S½) and South Half (S½) of the North Half (N½) of Section Seventeen (17); the North Half (N½) and Southeast Quarter (SE¼) of Section Nineteen (19); all in Township Three (3) South, Range Ten (10) West, S. B. M., estimated to contain 2240 acres; reserving therefrom for roads, railroads and ditches, a strip of land 30 feet wide along, adjoining and each side of the township and section lines, and a strip of land 20 feet wide along, adjoining and each side of the quarter section lines.

TOGETHER with all and singular the tenements, hereditaments and appurtenances thereunto belonging, or in anywise appertaining, and the reversion

and reversions, remainder and remainders, rents, issues and profits thereof.

TO HAVE AND TO HOLD all and singular the said premises together with the appurtenances, unto the said party of the second part, and to its successors and assigns forever.

IN WITNESS WHEREOF, the said parties of the first part have hereunto set their hands and seals the day and year in this indenture first above written. [60]

[Seal] EDMUND W. BACON,

[Seal] ANNA BACON.

Signed, sealed and delivered in the presence of M. T. OWENS.

State of California,
County of Los Angeles,—ss.

On this 12th day of January, in the year of our Lord one thousand nine hundred and five, before me, M. T. Owens, a Notary Public in and for the County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Edmund W. Bacon and Anna Bacon, his wife, known to me to be the persons described in and whose names are subscribed to the foregoing instrument, and they acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] M. T. OWENS,
Notary Public in and for the County of Los Angeles, State of California.

I, Edmund W. Bacon, Secretary of the Murphy Oil Company, a corporation, grantee in the within deed, do hereby certify that the capital stock of said corporation is divided into 20,000 shares of the par value of One Hundred Dollars ($100) each, all of which stock is outstanding; that as shown by the stock books of said corporation, the said shares of stock are now held by the following named persons to the number set opposite their names:

Simon J. Murphy	19,996
William H. Murphy	1
William Plotts	1
E. W. Bacon	1
Frank C. Owens	1
Total	20,000 shares

WITNESS my hand this 9th day of January, 1905.

EDMUND W. BACON [61]

State of California,
County of Los Angeles,—ss.

On this 12th day of January, in the year of our Lord one thousand nine hundred and five, before me, M. T. Owens, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Edmund W. Bacon, Secretary of Murphy Oil Company, known to me to be the person in and whose name is subscribed to the foregoing instrument, and he acknowledged to me that he executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] M. T. OWENS,
Notary Public in and for the County of Los Angeles, State of California.

I, Simon J. Murphy, owner and holder of more than two-thirds of the outstanding stock of the Murphy Oil Company, a corporation, grantee in the within deed, do hereby consent to the purchase by said corporation of the lands described in said deed, and hereby ratify said deed.

SIMON J. MURPHY,
William H. Murphy as to S. J. M.

State of Michigan,
County of Wayne,—ss.

On this 26th day of January, in the year one thousand nine hundred and five, before me, a Notary Public in and for the said County of Wayne, residing therein, duly commissioned and sworn, personally appeared Simon J. Murphy, known to me to be the person described in and whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal, the day and year in this certificate first above written. [62]

[Seal] WILLIAM H. WETHERBEE,
Notary Public in and for Wayne County, State of Michigan.

My commission expires Jany. 8, 1907.

A full, true and correct copy of the original recorded at the request of the Murphy Oil Company November 13, 1907, at 13 min. past 2 P. M.

GEO. E. PETERS, Recorder [63]

State of California,
County of Orange,—ss.

I HEREBY CERTIFY The foregoing to be a full, true and correct copy of the instrument appearing recorded in Book No. 157 of Deeds, page 54, Records of Orange County, and that I have carefully compared the same with the original record.

IN WITNESS WHEREOF I have hereunto set my hand and affixed my official seal this 24 day of September, 1928.

(Seal) JUSTINE WHITNEY,
County Recorder. [64]

No..... Dept.....

In the Superior Court of the County of Los Angeles, State of California.

MARIA BASTANCHURY, Administratrix with the will annexed of the estate of Domingo Bastanchury, deceased,

Plaintiff.

vs.

MURPHY OIL COMPANY, a corporation, and EDMUND W. BACON,

Defendants.

COMPLAINT FOR RELIEF ON THE GROUND OF FRAUD AND FOR AN ACCOUNTING.

The above named plaintiff complains of the above named defendants and for cause of action alleges:

1. Ever since August 18, 1904, defendant Murphy Oil Company has been, and now is, a corporation duly organized and existing under and by virtue of the laws of the state of California, with its principal place of business in the city of Whittier, in the county of Los Angeles, in said state.

2. For many years prior to April 1, 1903, and down to the time of his death, on or about July 21, 1909, said Domingo Bastanchury and Maria Bastanchury were husband and wife. Said Domingo Bastanchury was a Basque, a native of France, and, although long a resident of the state of California, he never became familiar with the English language and neither spoke, wrote, nor understood the same. Said Maria Bastanchury acted as interpreter for said Domingo, and he entrusted to her the transaction of such of his business as required the use of the English language. Said Domingo Bastanchury was by occupation a stock rancher, engaged in raising sheep, cattle, and other kinds of livestock, and also various grain crops both for sale and for the subsistence of his livestock, and spent, during the years 1904 [65] and 1905, a large part of his time away from the residence of himself and his said wife and in the camps of his employes, who were largely of the same race and speech with himself. Neither said Domingo Bastanchury nor said Maria Bastanchury, at any of the times hereinafter stated, had any knowledge of, or experience in, the business of discovering oil, or determining whether land contained, or was likely to contain, oil, and neither of them had any knowledge of, or experience in, the

business of drilling wells for the discovery or production of oil and gas, or with the appearances or facts which, in the progress of the drilling of such a well, would indicate that oil had been struck.

3. Said Domingo Bastanchury died on or about July 21, 1909, in the county of Orange, state of California, he, said decedent, being at said time a resident of said county, and leaving estate therein. Said Domingo Bastanchury left a last will and testament dated October 30, 1893, wherein one Orel N. Goldaracena was named as executor, who thereafter, to-wit, May 22, 1918, in writing, renounced his right to act as executor of said will. June 18, 1918, plaintiff, Maria Bastanchury, filed her petition with the Clerk of the Superior Court of said county of Orange for the admission of said will to probate and the issuance to her of letters of administration with the will annexed of the estate of said decedent. Such proceedings were thereafter had in said court, in the matter of said estate, that July 5, 1918, said court, by its order duly given and made, admitted said will to probate as the last will and testament of said decedent, and directed letters of administration with the will annexed to issue to plaintiff, Maria Bastanchury, upon her taking the oath required by law, and giving bond as required by said order. Thereafter, and on the same day, said Maria Bastanchury duly qualified by taking such oath and giving said bond, and thereupon the clerk of said court [66] under the seal thereof, on said 5th day of July, 1918, issued such letters of administration to said Maria Bastanchury, which letters have not been

revoked, and she ever since has been, and now is, the duly appointed, qualified and acting administratrix with the will annexed of the estate of said decedent.

4. April 1, 1903, said Domingo Bastanchury was the owner of all that certain real property situate in the county of Orange, state aforesaid, and more particularly described as follows, to-wit:

The E. ½ of N. W. ¼, and the S. W. ¼ of the N. W.¼, the S. ½ of the N. W. ¼ of the N. W.¼, and the E. ½ of the N. ½ of the N. W. ¼ of the N. W. ¼ and the S. W. ¼ of Sec. 15; the S. ½ of the N. E. ¼, the S. ½ of the N. ½ of the N. E. ¼, and the S. ½ of the N. W. ¼, and all of the South ½ of Section 16.

The S. ½ of the N. E. ¼, the N. W. ¼, and the S. ½ of Section 17. All of section 18. The N. ½ and S. E. ¼ of Section 19. All of section 20; all of section 21; the N. ½ of section 28; the N. ½ of Section 29, and the N. E. ¼ of Section 30; all being situate in Township 3 South, Range 10 West, S. B. M., in the County of Orange, State of California, being 4590 acres more or less.

By indenture of lease dated April 1, 1903, said Domingo Bastanchury and Maria Bastanchury, his wife, leased the real property above described to one Simon J. Murphy for a period of twenty years, for the purpose and to the end that, in compliance with the covenants and provisions of the said indenture of lease, the said Murphy should drill and operate wells for the discovery and production of petroleum oil and gas on and from said real prop-

erty, which indenture of lease is in the words and figures following to wit:

"LEASE.

THIS INDENTURE, Made and entered into this first day of April, A. D., 1903, by and BETWEEN Domingo Bastanchury, and Maria Bastanchury, husband and wife, of the County of Orange, State of California, the parties of the first part, [67] and Simon J. Murphy, of Detroit, Michigan, the party of the second part,

WITNESSETH: That the said parties of the first part, for and in consideration of the sum of One Thousand ($1000) Dollars to them in hand paid, the receipt whereof is hereby acknowledged, and in the further consideration of the covenants and agreements on the part of the said second party hereinafter contained, have granted, bargained, sold and conveyed, and by these presents do grant, bargain, sell and convey unto the said party of the second part, and to his heirs and assigns, the right and privilege for the period of twenty years from and after the date hereof, to dig, drill, bore for, develop, mine, extract, receive, hold, own, sell and remove all oil or gas that lies within, upon or under the following described land, to wit:

The E. ½ of N. W. ¼, and the S. W. ¼ of the N. W. ¼, the S. ½ of the N. W. ¼ of the N. W. ¼, and the E. ½ of the N. ½ of the N. W. ¼ of the N. W. ¼ and the S. W. ¼ of Sec. 15; the S. ½ of the N. E. ¼, the S. ½ of the N. ½ of the N. E. ¼, the S. ½ of the N. W. ¼, and all of the South ½ of Section 16.

The S. ½ of the N. E. ¼, the N. W. ¼, and the S. ½ of Section 17. All of section 18. The N. ½ and S. E. ¼ of Section 19. All of Section 20; all of Section 21; the N. ½ of Section 28; the N. ½ of Section 29, and the N. E. ¼ of Section 30; all being situate in Township 3 South, Range 10 West, S. B. M., in the County of Orange, State of California, being 4590 acres, more or less.

And the said party of the second part is hereby granted the right of way for ingress or egress to, from and across the said land, and the right to take, erect and maintain on the land hereinbefore described, and remove therefrom at the expiration or sooner termination of this lease, or when no longer in use, all necessary pipe, pipe lines, tools, machinery, equipments, materials, buildings, oil tanks, receptacles and apparatus whatsoever used or to be used in or about the full and complete exercise and enjoyment of the right or privilege hereby granted. And in addition to the land hereinbefore described, the above grant of right of way for ingress or egress to said land, and the right to erect, maintain and remove all necessary pipe, pipe lines, tools, machinery, tanks, buildings, etc. therefrom, is extended to cover the following described property for the purpose of a pipe line and roadway to the Railroad, the maintenance of tanks for storage purposes at said Railway, and the necessary switches or turn-outs, to wit:

The S. ½ of Section 29, the S. E. ¼ of Section 30, the N. ½ of Section 31, the N. W. ¼ and the N. ½ of the N. ½ of the N. E. ¼ of Section 32, in

Township 3 South, Range 10 West, [68] S. B. M., in the County of Orange, and State of California.

And the said party of the second part hereby agrees that he will, within three months from the date hereof, commence the work of drilling a well, and prosecute said work with diligence until oil or gas in paying quantities has been struck, or until a depth of at least one thousand feet shall have been reached at the option of said second party. And in the event that oil or gas in paying quantities be struck, then said party of the second part agrees to pump said well, and such other well or wells as they may thereafter drill on said land in which oil or gas in paying quantities is struck, to the full capacity of the same at all times, Sundays and holidays excepted, and to extract and preserve the oil or gas, if in paying quantities, over and above that used by said party of the second part for lighting and fuel purposes at the well or wells, the time taken for accidents, repairs, or in pulling or cleaning the said well or wells, or other appliances, excepted, so long as such well or wells shall produce oil or gas in paying quantities, not less than three barrels per day of twelve hours pumping, and in the event oil or gas in paying quantities be struck in said first well, then said party of the second part agrees to, within thirty days, of the completions of said first well, commence the work of boring a second well, and prosecute said work diligently to the same extent, in the same manner, and under the same conditions as well number one, and in the event of oil

being struck in well number two, then within the same time, and in the same manner, and under the same conditions to bore another well, and so on within the same time and in the same manner and under the same conditions to bore other wells during the existence of this lease.

And the said parties of the first part, in consideration hereof, are to have and receive one-eighth (1/8) of the net output of the oil from said well or wells, after deducting such quantities of oil as may be required for the operation of the mechanical plant used in producing and handling such output, and in drilling said well or wells, and doing the necessary pumping therefrom during the life of this lease, the said one-eighth (1/8) of such net output to be delivered to said parties of the first part by said party of the second part on the land hereby leased, and said second party to furnish storage capacity therefor for thirty days after the production of said output, without charge to the parties of the first part; at the end of which period, said parties of the first part are to remove said oil from the storage plants of said party of the second part.

And said parties of the first part shall receive one-sixteenth (1/16) of the net output of gas from said well or wells, after deducting such quantities of gas as may be required for the operation of the mechanical plant used in producing and handling such [69] output, and in drilling said well or wells, and operating the pumps connected with said business during the life of this lease, said royalty of gas to be delivered to said parties of the first part at the well or wells, and said parties of the first part

are to furnish all pipes to convey the same therefrom.

And the said party of the second part shall provide and maintain in perfect working order and condition, at the said well or tanks, accurate devices for measuring said net output, and shall keep full, true and perfect accounts, showing the amount of oil and gas produced, and said measuring devices and accounts shall at all times be open to the inspection of said parties of the first part, or either of them.

And in addition to the foregoing royalties, the said party of the second part agrees to pay unto the said parties of the first part, the sum of One Thousand ($1000) Dollars upon the first day of April of each and every year during the existence of this contract.

The said parties of the first part hereby reserve the right to use or let land hereby leased for all purposes not inconsistent with the rights and privileges granted by this lease, to wit: boring for oil and gas; and the use or letting of said land for general agricultural and grazing purposes shall not be deemed to be inconsistent with the rights and privileges hereby granted.

IT IS FURTHER PROVIDED That in case of a failure to bore any well or wells as provided by this contract, or at the expiration thereof at the end of twenty years, the land shall revert to said parties of the first part, except that said party of the second part, or his assigns, shall have the right to pump all producing wells that may already have been

bored and the right to maintain all necessary machinery, plants, pipe lines, etc. for the purpose of operation of said wells; provided, however, that said parties of the first part shall not thereafter be allowed to bore any well or wells within two hundred feet of any producing well, theretofore bored by the party of the second part, or his assigns.

Should water be found in wells in boring for oil, that are valueless for oil or gas, said first parties hereby reserve the right to the casing in such well or wells where water may be found on paying the reasonable value for said casing, and in that event, the casing in such well or wells is not to be removed, but in case that said party of the second part shall put in a water well for use by him, and afterwards abandons this lease, then said party of the second part shall leave the casing in such well, and the same shall revert to said parties of the first part without expense to them.

IT IS FURTHER UNDERSTOOD AND AGREED That if said party of the second part shall make a bona fide effort to put down a paying well, and shall fail after one year's effort to drill a producing well, that he has and hereby retains the privilege of terminating this lease after thirty days' notice in writing to [70] said parties of the first part.

IT IS FURTHER UNDERSTOOD AND AGREED That in case the price of oil at said wells or on board the cars at the nearest railroad siding at which the same may be shipped, is not, at least fifty cents per barrel of forty-two gallons, then said

second party may cease drilling until such time as the said oil can be sold for at least fifty cents per barrel at said place, and shall not forfeit his rights under the terms of this lease.

IT IS FURTHER AGREED THAT TIME is of the essence of this contract, and in the event of a failure to comply with any of the terms hereof by said party of the second part, or his assigns, said parties of the first part, and all of them, shall thereby be released from any and all obligations under this contract, and this contract shall thereby cease and determine, and the rights of said second party, or his assigns hereunder shall be forfeited.

AND IT IS UNDERSTOOD That the agreements and stipulations aforesaid are to apply to and bind the heirs, executors, administrators and assigns of the respective parties.

IN WITNESS WHEREOF, the said parties to these presents have hereunto set their hands and seals in duplicate, the day and year first above written.

DOMINGO BASTANCHURY, [Seal]
By MARIA BASTANCHURY [Seal]
his atty. in fact [Seal]
MARIA BASTANCHURY [Seal]
SIMON J. MURPHY [Seal]

State of California,
County of Los Angeles,—ss.

On this 9th day of April in the year one thousand, nine hundred and three A. D. before me, M. T.

Owens, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury personally known to me to be the person described in and whose name is subscribed to the within instrument, as the attorney in fact of Domingo Bastanchury and acknowledged to me that she subscribed the name of Domingo Bastanchury thereto as principal and her own name as attorney in fact.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal in said County, the day and year in this certificate first above written.

[Seal] M. T. OWENS,
Notary Public in and for Los Angeles County, State of California.
(Attorney in Fact) [71]

State of California,
County of Los Angeles,—ss.

On this 9th day of April in the year one thousand nine hundred and three A. D. before me M. T. Owens, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury personally known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that she executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] M. T. OWENS,

Notary Public in and for Los Angeles County, State of California.

(General)"

5. Thereafter, and on or about July 1, 1903, said Simon J. Murphy commenced to drill, and thereafter prosecuted the drilling of, a well for the discovery of, and the production therefrom of petroleum oil upon the northwest quarter of the southwest quarter of said section 18, which well was thereafter known as "Murphy-Coyote No. 1" and is hereinafter for brevity designated as well No. 1.

6. As plaintiff is informed and believes, and upon such information and belief alleges, the said Simon J. Murphy on or about August 18, 1904, caused defendant, Murphy Oil Company, to be incorporated, for the purpose and to the end that it might acquire and take over from said Simon J. Murphy and operate, certain oil properties, including the aforesaid lease from said Domingo and Maria Bastanchury, and the leasehold estate thereby created; and prior to November 1, 1904, said Simon J. Murphy assigned and transferred to defendant Murphy Oil Company the said indenture of lease and all interest therein of the said Murphy and also sundry other parcels of oil property; and, in consideration of such assignments and transfers, defendant Murphy Oil Company caused to be issued to said

Murphy shares of its capital stock, so that November 1, 1904, and until a time subsequent to [72] January 26, 1905, said Simon J. Murphy was the sole owner of all the issued and outstanding shares of the capital stock of said Murphy Oil Company, although certain persons, to wit, William H. Murphy, William Plotts, defendant Edmund W. Bacon, and Frank C. Owens, each held one share of said capital stock in his name, but solely for the purpose of qualifying the respective holders thereof to be and act as a director of said Murphy Oil Company; the one share each held by said last named persons being in truth and in fact the property of said Simon J. Murphy.

7. As plaintiff is informed and believes, and upon such information and belief alleges, the drilling of said well No. 1, in the first instance by said Simon J. Murphy, and, after his assignment of said lease to defendant Murphy Oil Company, by said Murphy Oil Company, was so proceeded with, pursuant to the terms of the aforesaid lease, that November 1, 1904, or shortly prior thereto, defendant Murphy Oil Company had struck oil in said well in paying quantities. Said defendants for the purpose, and with the intent, of cheating and defrauding said Domingo Bastanchury, as hereinafter alleged, concealed from said Bastanchury the fact that oil had been struck in said well, and used sundry means and devices for the prevention of said well coming in and of said well flowing oil; among others, upon and according to the information and belief of plain-

tiff, by keeping said well full of water, and so that the flow of oil therefrom would be, and was, restrained by the weight of a column of water of the approximate height of 3500 feet. As plaintiff is informed and believes, and upon such information and belief alleges, after said well had been drilled to the depth of about 3500 feet, and after the same had been drilled through about fifty feet of good, rich oil-sand, and while said well was prevented from flowing and producing oil by the weight of the column of water aforesaid, defendant Murphy Oil Company shut down work on said well, placed a watchman in charge thereof, capped *said* [73] said well with mechanical appliances adapted to the purpose of preventing, and which did prevent, the flow of oil and gas therefrom, and caused sundry persons who had been employed in the drilling of said well to make statements to sundry persons who inquired as to what had been encountered in drilling said well, and to noise abroad the rumor, that said well was a dry hole and that no oil had been struck therein.

On or about November 5, 1904, and within a few days after said well had been so shut down, defendant Edmund W. Bacon, who was at said time secretary of defendant Murphy Oil Company and purchasing agent of said defendant, at the residence of said Domingo and Maria Bastanchury, in the absence of said Domingo, for the purpose of inducing said Domingo Bastanchury to sell to defendant Murphy Oil Company a part of the land described in

said lease, including that part thereof on which said well was located, and of inducing said Domingo to cancel said lease, falsely represented and stated to said Maria Bastanchury that the said well was a failure, that it was a dry hole, that there was no oil in it, that defendant Murphy Oil Company had abandoned further work on it, that there was water in said well but no oil, but that the water therein was salty; and said Bacon then and there further stated and represented to said Maria Bastanchury that said Murphy Oil Company would sell to said Domingo Bastanchury, pursuant to the provisions of the said lease, the casing in said well for $10,000.00 should said Domingo desire to purchase the same. Said Maria Bastanchury thereupon reported the false statements above alleged of said Bacon to said Domingo Bastanchury, and also said Bacon's offer on behalf of defendant Murphy Oil Company to sell the casing in said well to said Domingo for $10,000.00. Said Murphy Oil Company had authorized and instructed said Bacon to make the said false representations and the said offer for the purpose and to the end that the said offer might be rejected, [74] but that, by the making of the same said Domingo Bastanchury, and his said wife Maria, should be induced to believe and be convinced that said well was a failure, that no oil had been struck therein, that said Murphy Oil Company proposed to abandon the same; and defendant Murphy Oil Company caused said Bacon to offer the casing in said well to said Bastanchury well know-

ing that a well of salty water would be valueless to him, and contriving and intending by such offer to induce him to believe that said Murphy Oil Company proposed to forfeit its said lease and abandon the business of exploring the real property described therein for the discovery and production of oil or gas. A few days after said visit said Bacon returned to the residence of said Bastanchurys and was informed by said Maria that said Domingo Bastanchury would not purchase the casing in said well at the price of $10,000.00, whereupon said Bacon, in furtherance of the aforesaid purpose of said Murphy Oil Company of inducing said Domingo Bastanchury to sell to said defendant a part of the land described in said lease, including that part thereof on which said well was located, and of inducing said Domingo to cancel said lease, stated and represented to said Maria Bastanchury, (who was then and there acting on behalf of said Domingo), that defendant Murphy Oil Company was unwilling to proceed further with the drilling of wells for the discovery or production of petroleum oil or gas on the lands covered by said lease, but that said defendant would be willing to buy approximately one thousand acres of the lands covered by the said lease, including the land upon which said well was located, and would pay therefor the price of twenty-five dollars per acre. Thereupon said Maria Bastanchury reported the said offer of said Bacon to said Domingo, who, relying on and believing all of the aforesaid statements and representations of said

Bacon, and believing that no oil had been [75] struck in said well, instructed said Maria to offer, on behalf of said Domingo, to sell certain parts of his said lands, aggregating about 2000 acres, which he called the "bluff" or "hilly lands" and which included the land on which said well was drilled. Negotiations with respect to such purchase continued between defendant Murphy Oil Company, acting through said Bacon, and said Bastanchury for a period of approximately two weeks; and said negotiations resulted in the agreement of said Domingo Bastanchury to sell to defendant Murphy Oil Company, and, by the instruction of said defendant, to convey the same by a deed executed by said Domingo and Maria Bastanchury to said Bacon, for the price of thirty-five dollars per acre, 2240 acres of the lands covered by the said lease, described as follows, to wit:

All of Sections Eighteen (18) and Twenty (20); South Half (S½) and South Half (S½) of North Half (N½) of Section Seventeen (17) and North Half (N½) and Southeast Quarter (SE¼) of Section Nineteen (19), Township Three (3) South, Range Ten (10) West, S. B. M.

upon the following conditions, to wit; that said Bastanchurys should and would release said Simon J. Murphy and said Murphy Oil Company from all the obligations of said lease of April 1, 1903, and join with said Murphy Oil Company in cancelling the same, and that said Bacon should and would execute a grazing lease, for grazing purposes only

to said Bastanchurys upon two thousand acres of the land for the period of ten years, at a rental of one thousand dollars per year.

8. Relying upon and believing the false representations and statements of defendant Murphy Oil Company, made by and through defendant Bacon as in paragraph 7 of this complaint alleged, said Domingo Bastanchury sold to defendant Murphy Oil Company the said 2240 acres of land described in paragraph 7 here- [76] of, and at the request of defendant Murphy Oil Company, said Domingo and Maria Bastanchury conveyed the same to defendant Edmund W. Bacon by deed dated December 15, 1904, executed to said Bacon by said Bastanchurys in the following words and figures:

THIS INDENTURE, Made the fifteenth day of December, in the year of our Lord one thousand nine hundred and four, BETWEEN Domingo Bastanchury and Maria Bastanchury, his wife, of Fullerton, California, the parties of the first part, and Edmund W. Bacon of Whittier, California, the party of the second part,

WITNESSETH: That the said parties of the first part, for and in consideration of the sum of One Thousand ($1000.00) Dollars in Gold Coin of the United States of America to them in hand paid by the said party of the second part, the receipt whereof is hereby acknowledged, do by these presents grant, bargain and sell, convey and confirm unto the said party of the second part and to his heirs and assigns forever, all that certain real prop-

erty situate in the County of Orange, State of California, and particularly described as follows:

All of Sections Eighteen (18) and Twenty (20); South Half (S½) and South Half (S½) of North Half (N½) of Section Seventeen (17) and North Half (N½) and Southeast Quarter (SE¼) of Section Nineteen (19), Township Three (3) South, Range Ten (10) West, S. B. M.

TOGETHER with all and singular the tenements, hereditaments and appurtenances thereunto belonging or in anywise appertaining, and the reversion and reversions, remainder and remainders, rents, issues and profits thereof.

TO HAVE AND TO HOLD all and singular the said premises, together with the appurtenances, unto the said party of the second part and to his heirs and assigns forever.

IN WITNESS WHEREOF the said parties of the first part have hereunto set their hands and seals the day and year in this indenture first above written.

DOMINGO BASTANCHURY [Seal]
By MARIA BASTANCHURY,
his atty. in fact.
MARIA BASTANCHURY [Seal]

State of California,
County of Los Angeles,—ss.

On this 16th day of December, in the year of our Lord, one thousand nine hundred and four, before, me, N. W. Thompson, a Notary Public in and for

said County of Los Angeles, State of Calif- [77] ornia, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, wife of Domingo Bastanchury, known to me to be the person described in and whose name is subscribed to the foregoing instrument, and she acknowledged to me that she executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for the County of Los Angeles, State of California.

State of California,
County of Los Angeles,—ss.

On this 16th day of December, in the year of our Lord one thousand nine hundred and four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, known to me to be the person whose name is subscribed to the within instrument as the attorney in fact of Domingo Bastanchury, and acknowledged to me that she subscribed the name of Domingo Bastanchury thereto as principal, and her own as attorney in fact.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for the County of Los Angeles, State of California.

A full, true and correct copy of the original recorded at the request of Grantee the 4th day of January, A. D., 1904, at 32 min. past 2 o'clock p. m. George E. Peters, County Recorder, by W. S. Gregg, Deputy."

Said deed was acknowledged by said Bastanchurys December 16, 1904, so as to entitle the same to be recorded, and was recorded at the request of said Bacon January 4, 1905, in the office of the county recorder of said county of Orange. Relying upon and believing the said false representations and statements of defendant Murphy Oil Company made by and through defendant Bacon, and as part of the same transaction with their said conveyance to defendant Bacon above mentioned, and in fulfilment of [78] the bargain relating thereto alleged in paragraph 7 of this complaint, said Domingo Bastanchury and Maria Bastanchury executed an instrument in writing to defendant Murphy Oil Company which was attached to said indenture of lease dated April 1, 1903, which said instrument in writing was acknowledged so as to be entitled to be recorded, and is in words and figures as follows, to wit:

"KNOW ALL MEN BY THESE PRESENTS: That we, DOMINGO BASTANCHURY and MARIA BASTANCHURY, husband and wife, of the County of Orange, State of California, and the MURPHY OIL COMPANY, a corporation organized and existing under the laws of the State of California, the assignee of Simon J. Murphy, do

hereby, for and in consideration of the sum of one dollar each in hand to the other paid, receipt whereof by each is hereby acknowledged, do hereby cancel the within indenture of lease; and said Murphy Oil Company, assignee of Simon J. Murphy, the lessee in said annexed lease mentioned, doth hereby surrender and yield up, on the same date hereof, unto the within named Domingo Bastanchury and Maria Bastanchury, the lands and premises in said lease mentioned, and the term of years therein yet to come, with all its right, title and interest thereto; and said Domingo Bastanchury and Maria Bastanchury do hereby acknowledge that the said within lease is hereby mutually terminated, and that they have received full satisfaction for all benefits which were to accrue to them under the terms of said lease, and said Simon J. Murphy and said Murphy Oil Company are hereby fully released and exonerated from all and every obligation in said lease contained upon their part to be kept and performed, and do hereby acknowledge full satisfaction of all demands which the said Domingo Bastanchury and Maria Bastanchury have or might have against the said Simon J. Murphy and said Murphy Oil Company, corporation aforesaid, or either of them, by reason of any of the covenants, conditions, stipulations or agreements in said lease contained or referred to.

IN WITNESS WHEREOF, the said Domingo Bastanchury and Maria Bastanchury have hereunto set their hands and seals the 24th day of December, A. D. 1904, and said Murphy Oil Company,

by resolution of its Board of Directors thereunto duly authorizing, hath hereunto caused its corporate name to be signed and its corporate seal affixed by its Secretary, the 24th day of December, 1904.

DOMINGO BASTANCHURY [Seal]
By MARIA BASTANCHURY,
his Atty in fact. [79]
MARIA BASTANCHURY [Seal]
MURPHY OIL COMPANY,
By EDMUND W. BACON,
Its Secretary. [Seal]

State of California,
County of Los Angeles,—ss.

On this 24th day of December in the year one thousand nine hundred four before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, known to me to be the person whose name is subscribed to the within instrument, as the Attorney in fact of Domingo Bastanchury and acknowledged to me that she subscribed the name of Domingo Bastanchury thereunto as principal and her own name as Attorney in fact.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official Seal the day and year in this Certificate first above written.

N. W. THOMPSON,
Notary Public in and for said Los Angeles County, State of California.

Acknowledgment—
Attorney in Fact. [Seal]

State of California,
County of Los Angeles,—ss.

On this 24th day of December in the year of our Lord One Thousand Nine Hundred four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury known to me to be the person whose name is subscribed to the within instrument and acknowledged to me that she executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for the County of Los Angeles,
State of California.

State of California,
County of Los Angeles,—ss.

On this 24th day of December in the year of our [80] Lord One Thousand Nine Hundred four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared, Edmund W. Bacon, ~~known to me to be the President and~~ known to me to be the Secretary of the Murphy Oil Company, the Corporation that executed the within instrument, and acknowledged to me that such Corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

[Seal] N. W. THOMPSON,

Notary Public in and for the County of Los Angeles, State of California."

As part of the same transaction, said Bacon, by indenture of lease, dated December 20, 1904, duly acknowledged December 24, 1904, so as to entitle the same to be recorded, and recorded at the request of said Domingo Bastanchury January 9, 1905, in the office of said county recorder of Orange County, did lease to said Bastanchurys, for the term of ten years, two thousand acres of said 2240 acres for grazing purposes only, at the yearly rental of $1,000.00 in gold coin of the United States, payable on the 20th day of December in each year, which said indenture of lease is in the following words and figures:

"THIS INDENTURE, Made and entered into this 20th day of December, 1904, by and between Edmund W. Bacon of Whittier, County of Los Angeles, State of California, the party of the first part, and Domingo Bastanchury and Maria Bastanchury, husband and wife, of the County of Orange, State of California, parties of the second part, WITNESSETH:

That the said party of the first part hath let, and by these premises doth demise and let unto the said parties of the second part, and said parties of the

second part have hired and taken, and by these presents do hire and take of and from the said party of the first part, all that certain real property lying and being situate in the County of Orange, State of California, and particularly described as follows:

All of the South Half (S½) of Section Seventeen (17); all of Section Eighteen (18) excepting that portion described as follows:

Commencing at a point on the west line of Section Eighteen (18), Township Three (3) South, Range Ten (10) W., S. B. M., four hundred and [81] fifty-three (453) feet south of an iron county post on the line between the counties of Los Angeles and Orange; thence North three thousand one hundred thirty-three and 8/10 (3133.8) feet to a 4x4 redwood post set by Charles T. Healy for the northwest corner of Section Eighteen (18), Township Three (3) South, Range Ten (10) West; thence South 89° 51′ East five thousand two hundred and eighty (5280) feet; thence South 0° 11′ East nine hundred and seventeen and 7/10 (917.7) feet to a point, said point being north of 0° 11′ West four hundred one and 3/10 (401.3) feet from a 2x4 redwood post set by Charles T. Healy; thence South 82° 15′ West two thousand three hundred three and 9/10 (2303.9) feet; thence South 28° 21′ West seven hundred fifty-seven and 5/10 (757.5) feet; thence South 14° 4′ West six hundred forty-four and 8/10 (644.8) feet; thence South 76° 9′ West six hundred (600) feet; thence North 89° 51′ West one thousand one hundred sixty and 1/10 (1160.1) feet; thence

South 58° 45′ West 872.5 feet to the place of beginning, containing two hundred and ten (210) acres of land;

All of the North Half (N½) and Southeast Quarter (SE¼) of Section Nineteen (19);

All of Section Twenty (20) excepting a rectangular piece of land containing thirty (30) acres in the Southeast corner of said Section Twenty (20), extending one thousand eight hundred and fifty (1850) feet north of the southeast corner of Section 20 and seven hundred six and 37/100 (706.37) feet west of the southeast corner of said Section 20; all in Township Three (3) South, Range Ten (10) West, S. B. M.

Said parcels hereinbefore described containing as a whole two thousand (2000) acres of land.

With the appurtenances for the term of ten (10) years from and after the first day of January, 1905, at a yearly rent or sum of One Thousand Dollars ($1000) in gold coin of the United States payable on the 20th day of December in each year. The said party of the first part hereby acknowledges that he has received the rent for the year 1905 at the time of the execution and delivery of this instrument. And it is agreed that if any rent shall be due and unpaid, or if default shall be made in any of the covenants, stipulations, conditions and agreements herein contained, then it shall be lawful for the said party of the first part to re-enter said premises and remove all persons therefrom and terminate this lease.

And the said parties of the second part do hereby covenant to pay to the said party of the first part the said rent herein reserved in the manner and at the time herein specified, time, with respect to said payments of annual rent, being of the essence of this agreement.

And the said parties of the second part likewise covenant and agree not to assign this lease [82] nor sublet the said premises without the written consent of the said party of the first part first had and obtained, and that at the expiration of the said term, or any sooner termination of this lease, the said parties of the second part will quit and surrender the premises hereby demised in as good order and condition as reasonable use thereof will permit, damages by the elements excepted; and if the said parties of the second part shall hold over the said term with the consent, expressed or implied, of the party of the first part, such holding shall be construed to be a tenancy only from month to month.

It is further agreed and understood by and between the parties hereto that the use of the said premises by the said parties of the second part is limited to the surface of said land for grazing purposes only, and that no other use of said land by said parties of the second part shall be made than for such grazing. And said party of the first part reserves to himself, his heirs, executors, administrators and assigns, the right at all times to enter in and upon all or any part of said land at any time during the term of said lease that he or they may

see fit for the purpose of constructing roadways and pipe lines over and across said lands and erecting and maintaining on said lands derricks or other apparatus for use in drilling for oil or pumping oil therefrom, and maintaining upon said lands machinery, tools, drilling apparatus and such other apparatus as may be convenient or necessary to said party of the first part in carrying on and conducting upon said lands the general business of drilling for oil thereon, pumping and producing oil therefrom, and transporting or removing such oil from and off said lands, and the erection and maintaining on said premises of such buildings as may be useful, convenient or necessary to the said party of the first part in carrying on said oil producing operations and the business connected therewith.

And said party of the first part reserves to himself from the effect of this lease the right to himself, his heirs, executors, administrators and assigns, and all his or their employees and others transacting business with him or them upon said premises, to a free and uninterrupted ingress and egress to and from the said lands; and said party of the first part likewise reserves to himself, his heirs, executors, administrators and assigns, the right to erect and maintain at all times upon said premises, or upon such portions thereof as he or they may elect, tankage, reservoirs, or other receptacles for the purpose of storing oil therein.

And said parties of the second part in using the said leased premises, for grazing purposes as aforesaid, accept the use thereof for such purposes at their own risk with respect to any injury or accident that may happen to them, their servants, agents or employes or property, [83] and said parties of the second part hereby expressly waive all claim for damages against the said party of the first part for any injuries to themselves, their agents, servants, employes, stock, cattle, or other property which may happen in the use of said demised premises by said parties of the second part, and from any damages which may arise or be occasioned by the operations which shall be carried on upon said premises by said parties of the first part.

And said parties of the second part hereby covenant and agree to save and hold harmless at all times the said party of the first part from any damages or injuries which may happen or be caused to the said parties of the second part, their agents, servants, employes, stock, cattle or other property by reason of the operations which shall or may be carried on by said party of the first part upon said leased premises.

It is further agreed and understood that this instrument and all of its provisions shall be binding upon the heirs, executors, administrators and assigns of the respective parties.

IN WITNESS WHEREOF, the said parties of the first and second part have hereunto set their

hands and seals the day and year *in* first above written.

Executed in duplicate.

EDMUND W. BACON [Seal]
DOMINGO BASTANCHURY [Seal]
By Maria Bastanchury,
his attorney in fact.
MARIA BASTANCHURY [Seal]

State of California,
County of Los Angeles.—ss.

On this 24 day of December in the year of our Lord one thousand nine hundred and four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, known to me to be the person whose name is subscribed to the within instrument as the attorney in fact of Domingo Bastanchury, and acknowledged to me that she subscribed the name of Domingo Bastanchury thereto as principal, and her own name as attorney in fact.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for said Los Angeles County, State of California. [84]

State of California,
County of Los Angeles.—ss.

On this 24 day of December, in the year of our Lord one thousand nine hundred and four, before me, N. W. Thompson, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Edmund W. Bacon and Maria Bastanchury, known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] N. W. THOMPSON,
Notary Public in and for the County of Los Angeles, State of California.

A full true and correct copy of the original recorded at the request of Domingo Bastanchury Jan. 9, 1905, at 43 min. past 1 P. M.

GEO. E. PETERS, Recorder,
Justine Whitney, Deputy."

By indenture dated January 9, 1905, said Edmund W. Bacon and Anna Bacon, his wife, granted and conveyed to defendant Murphy Oil Company the real property conveyed as above alleged to said Bacon by said Bastanchurys; which said indenture was duly acknowledged so as to entitle the same to be recorded, and was, at the request of defendant Murphy Oil Company recorded in the office of said

county recorder of said county of Orange November 13, 1907, and was and is in the following words and figures:

"THIS INDENTURE, Made the 9th day of January, in the year of our Lord one thousand nine hundred and five, between EDMUND W. BACON and ANNA BACON, his wife, of Whittier, California, the parties of the first part, and Murphy Oil Company, a corporation organized and existing under the laws of the State of California, having its principal place of business in Whittier, California, the party of the second part,

WITNESSETH: That the said parties of the first part for and in consideration of the sum of Ten Dollars in Gold Coin of the United States of America to them in hand paid by the said party of the second part, the receipt whereof is hereby acknowledged, do by these presents grant, bar- [85] gain and sell, convey and confirm unto the said party of the second part, and to its successors and assigns, forever, all of that certain real property situate in the County of Orange, State of California, and particularly described as follows:

In the Ranchos La Habra, Los Coyotes and San Juan Cajon de Santa Ana, all of Sections Eighteen (18) and Twenty (20); the South Half (S½) and South Half (S½) of the North Half (N½) of Section Seventeen (17); the North Half (N½) and Southeast Quarter (SE¼) of Section Nineteen (19); all in Township Three (3) South, Range Ten (10) West, S. B. M., estimated to contain 2240

acres; reserving therefrom for roads, railroads and ditches, a strip of land 30 feet wide along, adjoining and each side of the township and section lines, and a strip of land 20 feet wide along, adjoining and each side of the quarter section lines.

TOGETHER with all and singular the tenements, hereditaments and appurtenances thereunto belonging, or in anywise appertaining, and the reversion and reversions, remainder and remainders, rents, issues and profits thereof.

TO HAVE AND TO HOLD all and singular the said premises together with the appurtenances unto the said party of the second part, and to its successors and assigns forever.

IN WITNESS WHEREOF, the said parties of the first part have hereunto set their hands and seals the day and year in this indenture first above written.

EDMUND W. BACON (SEAL)
ANNA BACON (SEAL)

Signed, sealed and delivered in the presence of
M. T. Owens.

State of California,
County of Los Angeles.—ss.

On this 12th day of January, in the year of our Lord one thousand nine hundred and five, before me, M. T. Owens, a Notary Public in and for the County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Edmund W. Bacon and Anna Bacon, his wife, known to me to be the persons described in and whose names

are subscribed to the foregoing instrument, and they acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] M. T. OWENS,
Notary Public in and for the County of Los Angeles, State of California.

I, EDMUND W. BACON, Secretary of the Murphy Oil [86] Company, a corporation, grantee in the within deed, do hereby certify that the capital stock of said corporation is divided into 20,000 shares of the par value of One Hundred Dollars ($100) each, all of which stock is outstanding; that as shown by the stock books of said corporation, the said shares of stock are now held by the following named persons to the number set opposite their names:

Simon J. Murphy	19,996
William H. Murphy	1
William Plotts	1
Edmund W. Bacon	1
Frank C. Owens	1
Total	20,000 shares

WITNESS my hand this 9th day of January, 1905.

EDMUND W. BACON.

State of California,
County of Los Angeles.—ss.

On this 12th day of January, in the year of our Lord one thousand nine hundred and five, before me, M. T. Owens, a Notary Public in and for said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared Edmund W. Bacon, Secretary of Murphy Oil Company, known to me to be the person in and whose name is subscribed to the foregoing instrument, and he acknowledged to me that he executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] M. T. OWENS,
Notary Public in and for the County of Los Angeles, State of California.

I, Simon J. Murphy, owner and holder of more than two-thirds of the outstanding stock of the Murphy Oil Company, a corporation, grantee in the within deed, do hereby consent to the purchase by said corporation of the lands described in said deed, and hereby ratify said deed.

SIMON J. MURPHY.

(William H. Murphy) as to S. J. M.

State of Michigan,
County of Wayne.—ss.

On this 26th day of January, in the year of our Lord one thousand nine hundred and five, be- [87]

fore me, a Notary Public in and for the said County of Wayne, residing therein, duly commissioned and sworn, personally appeared Simon J. Murphy, known to me to be the person described in and whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal, the day and year in this certificate first above written.

[Seal] WILLIAM H. WETHERBEE,
Notary Public in and for Wayne County,
State of Michigan.

My commission expires Jany. 8, 1907.

A full, true and correct copy of the original recorded at the request of the Murphy Oil Company November 13, 1907, at 13 min. past 2 P. M.

GEO. E. PETERS, Recorder.
Deputy."

9. At the time when said defendant Murphy Oil Company, through defendant Bacon, represented to said Domingo Bastanchury, as alleged in paragraph 7 of this complaint that said well No. 1 was a failure, that it was a dry hole, that there was no oil in it, that said Murphy Oil Company had abandoned further work on it, and that the water therein was salty, both defendant Murphy Oil Company and defendant Bacon well knew that said representations, and each of them, were untrue, and they and each of them then well knew that said well was a successful oil well, that the water encountered in drilling it was not salty water, and that said well had pene-

trated rich oil sand and had struck oil. Said defendants, and each of them, made said false representations and statements to said Domingo and Maria Bastanchury for the purpose of inducing said Domingo Bastanchury to cancel said indenture of lease dated April 1, 1903, and to surrender his rights thereunder, and to sell to defendant Murphy Oil Company a large acreage of his said lands for a price far less than said lands were worth, and far less than said Domingo Bastanchury would have accepted therefor had he [88] known that oil had been struck in said well.

10. At no time during the negotiations of said Bacon with said Bastanchurys for the purchase of said 2240 acres of land did said Bacon or said Murphy Oil Company, either through said Bacon or otherwise, inform said Domingo and Maria Bastanchury, or either of them, that oil or oil sand had been struck in said well, or that the water in said well was not salt water, and said Domingo Bastanchury sold and said Domingo and Maria Bastanchury conveyed said land, as in paragraphs 7 and 8 of this complaint alleged, believing that said well was a dry hole and a failure, and that said Murphy Oil Company had failed to strike oil therein.

11. Neither said Domingo Bastanchury nor said Maria Bastanchury had any knowledge, information, notice or suspicion that said Murphy Oil Company had struck oil in said well No. 1 prior to the time when said Bacon made said representations, or of the falsity of any of the aforesaid state-

ments and representations of the said Bacon during the times when said Bacon was negotiating for the purchase of said 2240 acres of land, or prior to the time when said Bastanchurys conveyed said 2240 acres of land to said Bacon; nor did they, or either of them, have any such knowledge, information, notice or suspicion at any time during the lifetime of said Domingo; nor did said Maria Bastanchury have any such knowledge, information, notice or suspicion at any time prior to February 18, 1918. Said Domingo Bastanchury did not at any time know and had not at any time any notice, information or suspicion that at the time said Bacon made said false representation on behalf of defendant Murphy Oil Company and purchased said lands on said defendant's behalf, both said Bacon and said Murphy Oil Company well knew that said Murphy Oil Company had struck oil in paying quantities in said well No. 1, and that the same was a [89] successful oil well, drilled into a paying and productive oil sand; nor did said Maria at any time prior to February 18, 1918, have any such knowledge, notice, information or suspicion. At the time said Murphy Oil Company struck oil in said well No. 1 as aforesaid, and at all times thereafter, both defendants Murphy Oil Company and Bacon purposely concealed from both said Domingo Bastanchury and said Maria Bastanchury during the lifetime of said Domingo, and after his death, concealed from Maria, the fact that said Murphy Oil Company had struck oil in said well No. 1, as here-

inbefore alleged, and that both said defendants knew that said well had encountered oil and had penetrated a productive oil sand prior to the making of said false representations set forth in paragraph 7 of this complaint by said Bacon to said Bastanchurys; and, in particular, said defendants, to render such concealment the more effective, did the following acts, as plaintiff is informed and believes and upon such information and belief alleges, to-wit:

Prior to said Bacon approaching said Bastanchurys with respect to a proposed sale of the casing in said well No. 1 to said Domingo Bastanchury, as alleged in said paragraph 7, said Murphy Oil Company, in drilling said well No. 1, kept said well full of water covering the oil strata penetrated by said well, and thereby preventing the escape and the flow therefrom of oil and gas; and said defendants caused sundry persons who inquired as to whether oil had been encountered in said well to be told that the same was a dry hole and an unsuccessful well. Traces of oil which had escaped from said well were concealed by defendants by covering the same with brush; and the scum of oil on the water flowing therefrom was burned at night by said defendants, to the end that neither said Bastanchurys or any passerby might see evidences around said well that oil had been struck therein. After the said sale and conveyance of said [90] 2240 acres, as alleged in paragraphs 7 and 8 of this complaint, and about the end of the month of January, 1905, said Murphy Oil Company commenced

the erection of a derrick made preparations to drill and commenced the drilling of a second well on said 2240 acres about three-quarters of a mile to the eastward of said first well, and proceeded with the drilling of said second well until on or about July, 1906, at or about which time the drilling of said second well was finished; said second well is herein for brevity referred to as well No. 2. About the time said well No. 2 was so finished, said Murphy Oil Company cleaned out said well No. 1, and thereupon said well No. 1 became a flowing oil well and thereafter produced great quantities of oil.

12. Said Domingo Bastanchury did not at any time, nor did said Maria Bastanchury at any time prior to February 18, 1918, know or suspect that defendant Murphy Oil Company had struck oil in said first well No. 1 before the making by said Bacon of the aforesaid false and fraudulent representations, nor did Domingo Bastanchury at any time know or suspect, nor did said Maria Bastanchury at any time prior to February 18, 1918, know or suspect that defendants, Murphy Oil Company and Edmund W. Bacon, knew, at the time said false and fraudulent representations were so made, that oil had been struck in said well; but, to the contrary, said Domingo Bastanchury at all times, and Maria Bastanchury at all times prior to February 18, 1918, supposed and believed that said Murphy Oil Company had, after the completion of said well No. 2 deepened said well No. 1, and by such deepening, for the first time, and not before,

struck oil therein. Said Domingo Bastanchury did not at any time, nor did said Maria Bastanchury at any time prior to February 18, 1918, know or suspect that, at the time when said Bacon so made said false representations and said Domingo Bastan- [91] chury sold, and conveyed to said Bacon, said twenty-two hundred and forty acres of land, said Bacon and said Murphy Oil Company both well knew that oil had been struck in the drilling of said well No. 1, nor did said Domingo Bastanchury at any time, know or suspect, or have any reason to suspect, nor did said Maria Bastanchury at any time prior to February 18, 1918, know or suspect, or have any reason to suspect, that any of the aforesaid representations of said Bacon were false.

13. The commission of the acts of fraud herein alleged was discovered in manner following, to-wit: February 18, 1918, one C. E. Tower was drilling a well for the discovery and production of water on certain lands in which one Gaston A. Bastanchury, a son of said Domingo Bastanchury and said Maria Bastanchury, was interested, at a point about three miles distant from said well No. 1. When said water well had been drilled to a depth of about 200 feet said Tower pulled the drilling tools out of said well and found a ball of shale in the mud scow, which he, later on said day, exhibited to said Gaston A. Bastanchury and told him (said Gaston) that he (said Tower) believed that there was oil under the land on which he was drilling said water well; and in a conversation, which then and there ensued between said

Tower and said Gaston A. Bastanchury, mention was made of a certain well located in said Orange County (known as the Birch well) concerning which certain persons interested therein claimed that they had been defrauded in parting with their interests, by reason of the concealment from them that oil had been struck in said well, and said Tower further stated to said Gaston A. Bastanchury, in referring to said claims of fraud made by such persons, "That is no worse than what the Murphy Oil Company did to your folks." Said Gaston thereupon inquired of said Tower as to what he (said Tower) knew concerning what the Murphy Oil Company had done to said Gaston's relatives; [92] to which said Tower replied that he had heard a number of persons state that the family of said Gaston had been "skinned" out of their land, and stated that he, said Tower, believed that he could find a number of witnesses to substantiate the fact that there were good indications of oil in the well that had been drilled upon their said land at the time said Domingo Bastanchury sold said land to defendant Murphy Oil Company.

Said Tower, then and there further stated to said Gaston that he (said Tower) had, before the sale of said real property to defendant Murphy Oil Company, seen where oil had been thrown on the roof of the derrick of said well No. 1 by the drilling cables, and said Tower furnished said Gaston with the names of other persons who had seen indications of the existence of oil in said well No. 1 prior to said sale. Soon thereafter said Gaston informed plaintiff of the aforesaid statements of said

Tower, and thereupon plaintiff consulted counsel with respect to said statements, and was advised that an investigation of the facts relative to the discovery of oil in said well No. 1 should be made. Plaintiff employed a competent investigator, who, with the assistance of said Gaston, made an investigation of said facts by interviewing former employees of defendant Murphy Oil Company, who had worked on said well, and divers and sundry other persons experienced in the oil business who had visited said well while it was being drilled, and learned from said persons, and through said investigation, that prior to said well being shut down, on or about November 1, 1904, stains of oil were visible on the roof of the derrick of said well, where the same had been thrown by the operation of the drilling cables; that said well had, when the same was shut down, as aforesaid, been capped with a gate for the purpose of preventing the escape of water and oil therefrom; that there was a good showing of oil in said well at the time said [93] well was shut down and capped; that said well had been kept full of water in order to prevent, as far as possible, the escape therefrom of oil and gas; that, notwithstanding said precautions, water mingled with oil flowed from said well through pipes that had been connected with certain of the casings in said well, and said water and oil had been conducted to a tank and also to two deep sumpholes at some little distance from said well; that before any further work had been done on said

well after the sale of said 2240 acres, alleged in paragraphs 7 and 8 of this complaint, oil from said well had, through the pipe aforesaid, flowed into said tank and sumpholes and there collected in large quantities, and that a large portion of said oil had been pumped therefrom and used by said Murphy Oil Company as fuel in the drilling of the second well, or well No. 2; that the existence of said sumpholes had been concealed by boarding the same over, and covering the same with brush; and that the employes of said Murphy Oil Company had been instructed to open, and did open, the gate with which said well was capped only when the pressure thereon reached a certain point, and were instructed to exercise great care with reference to the escape of water and oil therefrom, and to remove and destroy all evidences of oil flowing from said well; and that the matters and things above mentioned were observed and done prior to any resumption of work on said well after the same had been shut down and capped, as above alleged, on or about November 1, 1904.

During said investigation said Gaston A. Bastanchury discovered and examined a copy of the log of said well No. 1, which said log contained the statements that drilling on said well had started July 1, 1903, and that said well was completed November 20, 1904, that in drilling said well shale had been first encountered between the depths of 1905 and 2200 feet, that at the depth of 2600 feet hot water had flowed over the top of the casing;

that at between 3300 feet and 3430 feet the drilling of said well had en- [94] countered shale and shells—oil and gas, that at between 3430 feet and 3500 feet the drilling of said well had encountered shale and a good show of oil, and that between the depths of 3500 feet and 3560 feet said well had passed through shale and good rich oil sand.

14. Subsequent to the drilling and bringing in of said two wells, Murphy Coyote No. 1 and Murphy Coyote No. 2, as hereinabove alleged, defendant Murphy Oil Company drilled and brought in divers wells producing oil on said 2240 acres of land, the number of which wells is unknown to plaintiff, and sold the oil produced therefrom; but plaintiff is not advised, and cannot state, either the amount of oil so produced and sold, or the prices or amount of money received therefor by defendant Murphy Oil Company. As plaintiff is informed and believes and upon such information and belief alleges, some time in the year 1909 defendant Murphy Oil Company entered into a contract with Standard Oil Company of California, a corporation organized and acting under the laws of the state of California, whereby said Standard Oil Company undertook the operation of said real property for the production of oil therefrom; and thereafter, but at what time plaintiff is not informed and cannot state, the said Murphy Oil Company sold said 2240 acres of land to said Standard Oil Company of California for a consideration of $4,000,000.00, or thereabouts, to be paid to said Murphy Oil Company by said Standard Oil Company, but whether

said consideration was agreed to be paid in cash, or in shares of the capital stock of said Standard Oil Company of California, or partly in cash and partly in stock or other things of value, plaintiff is not informed and cannot state; but said sale reserved to defendant Murphy Oil Company, in addition to said consideration of $4,000,000.00, a royalty of one-fourth of all the oil and gas to be thereafter produced from said real property, which royalty oil and gas defend- [95] ant Murphy Oil Company agreed to sell to said Standard Oil Company of California, and said Standard Oil Company agreed to purchase the same. Plaintiff is further informed and believes, and upon such information and belief alleges, that said Standard Oil Company of California has heretofore paid and rendered to defendant Murphy Oil Company, on account of said consideration of $4,000,000.00, upwards of $2,000,000.00; and that said Murphy Oil Company has also received from sales of its oil, prior to said sale to said Standard Oil Company of California, and from the sales to said Standard Oil Company of the royalty oil and gas aforesaid, large sums of money, the amounts of which payments and receipts are unknown to plaintiff; that said Standard Oil Company has drilled and brought in many wells on said real property which have produced, and many of which are still producing oil and gas, and will continue to produce oil and gas for a long time to come, the number of which wells is unknown to plaintiff; and that said Standard Oil Company will for many years to come continue to drill and bring in wells

producing oil and gas on said real property; and that said Murphy Oil Company will, under the terms of the sale aforesaid, be entitled to the proceeds of the sales of the royalty oil and gas from the production of said wells, which proceeds of sale will, as plaintiff is informed and believes, and upon such information and belief alleges, amount to $15,000,000.00 or upwards; that, as plaintiff is informed and believes, and upon such information and belief alleges, defendant Murphy Oil Company has already obtained moneys and other things of value, by virtue of said sale, from said Standard Oil Company of California, exceeding $5,000,000.00, of which the excess over the sum of $78,400.00 has been obtained by said Murphy Oil Company by means of the fraud, false representations and fraudulent concealments of said Murphy Oil Company in this complaint alleged. [96]

15. As plaintiff is informed, believes, and upon such information and belief alleges, defendant Murphy Oil Company has paid over, transferred and turned over to defendant Edmund W. Bacon, and he has received, a portion of the moneys and things of value received by defendant Murphy Oil Company from its dealings with said 2240 acres of land, as alleged in paragraph 14 of this complaint, but plaintiff is not informed as to, and cannot state what amount of money or other things of value have been so received and obtained by defendant Bacon from defendant Murphy Oil Company.

16. Plaintiff further alleges that the consent of said Domingo Bastanchury to sell said 2240 acres

of land to defendant Murphy Oil Company and to cancel the hereinbefore mentioned lease to said Simon J. Murphy, and to accept said money consideration of $78,400.00 and said lease from defendant Bacon of 2000 acres of said land for grazing purposes, all as hereinbefore alleged, was induced and obtained by the false representations, statements and acts of defendants in this complaint above set forth; and without said false representations, statements and acts of defendant said Domingo Bastanchury would not have consented to said sale and to said cancellation, or to the execution of said deed to defendant Bacon, or the execution of said cancellation of said lease to said Murphy, or the execution, on the part of the lessees therein, of said grazing lease from said Bacon, as alleged in this complaint. Had said Domingo Bastanchury known or believed, prior to said sale and conveyance, that oil sand or oil had been struck in drilling said well No. 1, he would not have sold said 2240 acres to defendant Murphy Oil Company, or cancelled said lease to said Murphy, as herein alleged. And plaintiff further alleges upon and according to her information and belief that at the time of said sale and conveyance of said 2240 acres, said lands were, by reason of the striking of oil and oil [97] sand in said well No. 1, of an actual value of not less than five million dollars.

WHEREFORE, Plaintiff prays judgment that defendants, and each of them, be required to account to plaintiff for all moneys and other things of value obtained by them, or either of them, from or through

their, or either of their, dealings with the 2240 acres of land conveyed by Domingo Bastanchury and Maria Bastanchury to defendant Bacon, as alleged in paragraphs 7 and 8 of this complaint, or from their dealings with the proceeds either of sale or operation of said real property; and that said defendants, and each of them, be required to pay over and deliver to plaintiff all of the moneys, property and things of value obtained by them by reason of the sale of said lands, or the operation thereof, and to assign and transfer to plaintiff all rights of defendants to receive such moneys and things of value in the future; which moneys, rights, property and things of value shall exceed in value of sum of $78,400.00; plaintiff hereby submitting herself to such conditions, order and decree as to the court may seem just and equitable, the nature of the case and the premises considered; that a receiver be appointed to collect and receive from Standard Oil Company of California for the benefit of plaintiff, all moneys and other things of value which said Standard Oil Company of California has become obligated to pay over, or to deliver, to defendants, or either of them, either as royalty, rent, purchase price, or otherwise, of, or with respect to, said 2240 acres of land; and for such other and further relief as to the court may seem meet and agreeable to equity, the premises considered, and for costs.

BENJAMIN E. PAGE & ARTHUR C. HURT,
HUNSAKER, BRITT & EDWARDS,
W. EGBERT MITCHELL,
Attorneys for Plaintiff. [98]

State of California,
County of Los Angeles.—ss.

Maria Bastanchury, being first duly sworn, deposes and says: That I am the plaintiff named in the foregoing complaint; that I have read said complaint and know the contents thereof, and that the same is true of my own knowledge, except as to those matters which are therein stated upon information or belief, and as to those matters, I believe it to be true.

MARIA BASTANCHURY.

Subscribed and sworn to before me this 26th day of August 1918.

(Seal) NINA CLEAVER,
Notary Public in and for said
County of Los Angeles. [99]

[Endorsed]: Filed Aug. 28, 1918. [100]

(Title of Superior Court and Cause.)

SUMMONS.

Action brought in the Superior Court of the State of California, in and for the County of Los Angeles and the Complaint filed in said County of Los Angeles, in the office *at* the Clerk of said Superior Court.

The people of the State of California Send Greetings to:

MURPHY OIL COMPANY, a corporation, and EDMUND W. BACON, defendants.

You are hereby directed to appear and answer the Complaint in an action entitled as above, brought

against you in the Superior Court of the County of Los Angeles, State of California, within ten days after the service on you of this Summons—if served within this County; or within thirty days if served elsewhere.

And you are hereby notified that unless you appear and answer as above required the said plaintiff will take judgment for any money or damages demanded in the Complaint, as arising upon contract or said plaintiff will apply to the Court for any other relief demanded in the complaint.

Given under my hand and seal of the Superior Court of the County of Los Angeles, State of California, this 28th day of August, A. D., 1918.

(Seal) H. J. LELANDE, Clerk,
By E. A. WICKERSHAM,
Deputy Clerk. [101]

[Endorsed]: Filed Sep. 4, 1918. [102]

(Title of Superior Court and Cause.)

ANSWER OF DEFENDANTS.

Defendants for their joint and several answer to the complaint on file in the above entitled action, deny and allege as follows:

I.

Deny upon and according to their information and belief that said Domingo Bastanchury, deceased, never became familiar with the English language or ever spoke or understood the same; and

deny likewise that said decedent entrusted to Maria Bastanchury his wife, the transaction of all of his business which required the use of the English language, or that said wife acted as interpreter for said decedent whenever said decedent had occasion to converse in the English language.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer the allegation that said decedent never wrote the English language or to answer whether or not said wife ordinarily acted as interpreter for said decedent when he had occasion to converse in the English language, or to answer whether or not said decedent ordinarily entrusted to said wife the transaction of such of his business as required the [103] use of the English language, or to answer whether or not, during the years 1904 and 1905 said decedent spent a large part of his time away from the residence of himself and his said wife and in the camps of his employees, and basing their denials upon said ground, defendants deny that said wife ordinarily acted as interpreter for said decedent when he had occasion to converse in the English language, and deny that said decedent ordinarily entrusted to said wife the transaction of such of his business as required the use of the English language, and deny that during either of the years 1904 or 1905 said decedent spent any part of his time away from said residence or in said camps, or any of them.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer any of the allegations set forth or expressed in said complaint in words as follows:

"Neither said Domingo Bastanchury nor said Maria Bastanchary, at any of the times hereinafter stated, had any knowledge of, or experience in, the business of discovering oil, or determining, whether land contained, or was likely to contain, oil, and neither of them had any knowledge of, or experience in, the business of drilling wells for the discovery or production of oil and gas, or with the appearances or facts which, in the progress of the drilling of such a well, would indicate that oil had been struck."

and basing their denials upon said ground, defendants deny each and every of said allegations.

II.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer whether or not said decedent, upon his decease, owned or left any estate within the County of Orange, state aforesaid, or elsewhere, and basing their denials upon said ground, defendants deny that said decedent, upon his decease, owned or left any estate located within said [104] County of Orange, or elsewhere.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer the allegation contained in Paragraph 3

of said complaint to the effect that said decedent left a last will and testament dated October 30, 1893, wherein one Orel N. Goldaracena was named as executor, and basing their denials upon said ground, defendants deny that said decedent left such a last will and testament or any last will.

Defendants allege upon and according to their information and belief that said decedent, at the time of his decease, was not the owner or siezed of any estate or interest, legal or equitable, in or to any of the lands described or mentioned in said complaint, or any right of action or claim which had arisen out of or in connection with or accrued in favor of his wife and himself, or either of them, as a consequence of the transaction involving, among other things, the making of the sale and conveyance described in Paragraphs 8 and 9 of said complaint, and likewise deny that any such estate or interest in any part of said lands or any such right of action or claim passed upon the demise of said decedent either by will or by succession from him to any of his personal representatives, or any of his devisees or heirs.

III.

Deny that said well, at any time prior to the conveyance made by decedent and his said wife to defendant Bacon and referred to in said complaint, was drilled to any depth in excess of 3431 feet, or was drilled into or through fifty, or any other number, of feet of good or rich oil sand or any good or rich

oil sand, and deny that said well at any time was prevented from flowing or producing oil by the weight of any column of water or any water contained therein, and deny that said well, even had the same been [105] uncapped and entirely free from water, would have at any time prior to said conveyance to defendant Bacon last mentioned flowed or produced any oil; deny that the acts of shutting down said well, capping the same, and placing a watchman in charge thereof, referred to in said complaint, or either of said acts, was done or performed prior to November 26, 1904; deny that defendants or either of them at any time caused any person or persons to make sundry persons who inquired as to what was encountered in drilling said well, or to anyone, or to noise abroad the rumor that said well was a dry hole or that no oil had been struck therein.

Allege that they have no knowledge, information or belief sufficient to enable them to answer the allegation to the effect that sundry persons who had been employed in the drilling of said well to make statements to sundry persons who inquired as to what had been encountered in drilling said well, and to noise abroad the rumor that said well was a dry hole and that no oil had been struck therein, and basing their denials upon said ground defendants deny said allegation and every part thereof.

Deny that oil in paying quantities or a good show of oil was struck in the well designated No. 1 in

said complaint at any time prior to said conveyance to said Bacon.

Defendants allege that on or about November 26, 1904, the string of inner or 5-5/8 inch casing then in said well became disconnected or separated at the depth of about 1260 feet and that as a consequence of such separation of said string of casing, the water collected outside of said casing, together with the water coming from the formations which fed the space existing between said casing and the outer wall of said well forced its way into the portion of said inner casing located above said point of separation at the lower end of said portion of said casing and [106] caused an overflow of water containing particles or traces of oil at the upper end thereof.

Defendants admit that on the same day or the day thereafter, and soon after said overflow began, there was installed at the top of said 5-5/8 inch casing a gate or cap which was designed to prevent, and in fact did prevent, any further overflow from said inner casing, also that at or about the same time work on said well was suspended and that thereafter and until work upon said well was resumed said cap or gate was maintained for the purpose of preventing, and the same did in fact prevent, said well from overflowing, excepting at such times and to such extent as defendants should and did relieve the restraint imposed by said gate or cap for the purpose of avoiding any excessive pressure by opening said gate.

Defendants allege, however, that work on said well was resumed subsequently and that as a part of said work said string of casing was reunited and that as soon as the same was so repaired said well ceased to overflow; but defendants deny that said well as it then existed and when so repaired produced or was capable of producing oil in paying quantities or in any substantial quantity.

Defendants deny that they or either of them, for the purpose and with the intent, or for the purpose or with the intent of cheating and defrauding or cheating or defrauding said decedent as alleged in said complaint, or otherwise, concealed at any time from said Bastanchurys, or either of them, the fact of any striking of oil in said well or used at any time meanse and devises or any means or devise for the prevention of said well coming in or of said well flowing oil, or kept or at any time kept said well full of water or any water in said well so that the flow of oil there- [107] from would be or was restrained by the weight of said water, or at any time shut down work on said well or placed a watchman in charge thereof, or capped said well with any mechanical appliances or appliance, or caused sundry persons who had been employed in the drilling of said well, or any person, to make statements or any statement to sundry persons, or to any person who inquired as to what had been encountered in the drilling of said well that said well was a dry hole or that no oil had been struck therein, or to noise abroad the rumor that

said well was a dry hole or that no oil had been struck therein; and deny that they or either of them, for any purpose, concealed at any time from said Bastanchurys or either of them, the fact of the striking of any oil in said well struck at or prior to the time of the making by defendants, or either of them, of any of the statements or representations which were or was in fact made by defendants or either of them, and are mentioned in said complaint and alleged therein to be false.

IV.

Deny that defendant Bacon at any time or for any purpose falsely represented or stated to said wife of said decedent that said well was a failure or was a dry hole or that there was no oil in it or that defendant Murphy Oil Company or anyone else had abandoned further work on said well or that there was water in said well but no oil, or that the water therein was salty; deny that said Bacon at any time while acting or pretending to represent or act on behalf of defendant Murphy Oil Company, represented to said wife that said well was a failure or that said defendant had abandoned [108] or proposed to abandon further work on it or that there was no oil in said well or that said defendant would sell to said decedent the casing in said well for $10,000 or that said defendant would sell to said decedent any casing for any price or upon any basis.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to

answer any of the allegations of said complaint to the effect that said wife reported to said decedent that said Bacon had made to her the statements or representations that said well was a failure, that there was no oil in it, that it was a dry hole, and that defendant Murphy Oil Company had abandoned further work on it, that there was water in said well but no oil, and that the water therein was salty; also an offer by said Bacon on behalf of defendant Murphy Oil Company to sell the casing in said well to said decedent for $10,000, and basing their denials upon said ground, defendants deny that said wife reported to said decedent that said offer or any of said statements or representations had been made to her by said Bacon.

Deny that defendant Murphy Oil Company ever authorized, instructed or caused said Bacon to make any offer on behalf of defendant Murphy Oil Company, to sell the casing in said well or any casing to said decedent for $10,000 or for any other price or upon any basis, or to make any of the statements or representations hereinbefore mentioned, or to make any of the statements or representations set forth in said complaint and therein alleged to be false and to have been made by said Bacon to said wife.

Deny that defendant Murphy Oil Company ever authorized, instructed or caused said Bacon to make any offer to said wife for the purpose or to the end that said offer might be rejected, but that by the making of the same said decedent and his wife, or either of them, should be induced to believe or be

convinced that [109] said well was a failure or that no oil had been struck therein or that defendant Murphy Oil Company proposed to abandon said well, and deny that said defendant by any offer which it authorized, instructed or caused said Bacon to make, or any offer which said Bacon made while representing or acting or pretending to represent or act on behalf of said defendant, defendants or either of them contrived or intended to induce said Bastanchurys or either of them to believe that defendant Murphy Oil Company proposed to abandon said well or to abandon the business of exploring, for the discovery and production, or discovery or production, of oil and gas or oil or gas, the lands then covered by said lease of April 1, 1903, or any part thereof, or to believe that said defendant proposed to abandon or forfeit said lease or the leasehold estate created thereby.

Deny that said Bacon at any time or for any purpose stated or represented to said wife that said defendant Murphy Oil Company was unwilling to proceed further in the drilling of wells for the discovery or production of petroleum oil or gas on the lands covered by the lease hereinbefore mentioned, or that said defendant would be willing to buy approximately 1000 acres of the lands covered by said lease, including the land upon which said well was located, and would pay therefor the price of $25.00 per acre, or made to said wife any offer, statement or representation substantially to the effect of either of those last mentioned.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer whether or not said wife ever reported to said decedent that said Bacon had stated or represented to her that defendant Murphy Oil Company was unwilling to proceed further with the drilling of wells for oil or gas on the lands covered by said lease, or had stated or represented [110] that said defendant would be willing to buy approximately 1000 acres of said lands including the land upon which said well was located, and would pay therefor the price of $25.00 per acre, and basing their denials upon said ground, defendants deny that said wife reported to said decedent that said Bacon had made to her any such statement or representation.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer the allegations of said complaint to the effect that decedent instructed his said wife to offer, on his behalf, to sell to defendant Murphy Oil Company, certain parts of said lands aggregating about 2000 acres, which said decedent called or described as the "bluff or hilly lands" and which included the land upon which said well was drilled, and basing their denials upon said ground, defendants deny that said wife was so instructed by said deecdent.

Deny, upon and according to their information and belief, that decedent in giving to his wife any such instruction believed or relied upon any statement or representation made by said Bacon to the

effect that defendant Murphy Oil Company had abandoned said well or was unwilling to proceed further with the drilling of wells for oil or gas on the lands covered by said lease or that said well was a failure or was a dry hole, or that there was no oil therein; on the contrary, defendants allege, upon and according to their information and belief, that throughout the period during which it is alleged in said complaint the negotiations between said wife and said Bacon therein referred to were carried on, said decedent had notice and knowledge that neither said well nor work thereon had been abandoned, that indications of oil and gas had been encountered in the course of work of drilling said well; also notice and knowledge of the true character of the water found in said well. [111]

Defendants allege that negotiations were had between said decedent, acting by and through his said wife, and the defendant Murphy Oil Company, acting by and through said Bacon, which resulted in an agreement or offer by said decedent to sell to said Murphy Oil Company the 2240 acres of land particularly described in Paragraph 8 of said complaint, in consideration of the surrender by said defendant of said lease of April 1, 1903, together with the leasehold estate created thereby, and the cancellation of said lease, also the further considerations of the sum of $35.00 per acre for said 2240 acres of land, and of a lease for grazing purposes only to said Bastanchurys upon a certain 2000 acres of said land for a period of ten years at a rental of $1000 per year.

Deny that the negotiations had during the year 1904 between defendant Murphy Oil Company, acting by and through said Bacon, and said decedent, acting by and through said wife, in consummation of which or as a result of which the sale and conveyance described in Paragraphs 8 and 9 of said complaint were made, continued for a period of two weeks only; on the contrary, defendants allege that said negotiations continued for many weeks but that the same terminated prior to the month of November, 1904, and long prior to the time when said well No. 1 was shut down and work thereon suspended in the month of November, 1904.

V.

Defendants deny, upon and according to their information and belief, that said decedent made the agreement on his part mentioned in Paragraph 7 of said complaint, or sold to defendant Murphy Oil Company said 2240 acres of land, or made the conveyance mentioned in Paragraph 8 of said complaint in reliance upon or while believing any false representations or statements or representation or statement made by defendant Murphy Oil Company by or through [112] said Bacon, or made by said Bacon while acting for or pretending to act for said defendant.

Deny in like manner that said decedent and his said wife, or either of them, executed or delivered the instrument purporting to cancel and terminate said lease, a copy of which instrument is set forth in said Paragraph 8 of said complaint, while rely-

ing upon or believing any false representations and statements or representation or statement made by defendant Murphy Oil Company by or through said Bacon or made by said Bacon while acting or pretending to act for said defendant.

VI.

Deny that any representation was ever made to said decedent or his said wife that said well No. 1 was a dry hole or that there was no oil in it or that defendant Murphy Oil Company would abandon further work on it, or that said defendant had abandoned further work on said well or had abandoned or forfeited said lease, by defendant Murphy Oil Company by or through said Bacon or by said Bacon while acting or pretending to act on behalf of said defendant Murphy Oil Company, at any time when said defendant or said Bacon knew or believed that said representation was untrue or knew or believed that said well was a successful oil well, or that said well had penetrated rich or any oil sand or had struck oil, or at any time whatever.

Defendants admit that said Bacon did, during the course of said negotiations, represent to said wife that the water in said well was salty, but defendants deny that said representation was made during the month of November, 1904, and allege, on the contrary, that said representation was made long prior to said month; also allege that said representation was true. [113]

Deny that any false representations and statements or representation or statement was ever made

to said decedent or his said wife by defendant Murphy Oil Company through or by said Bacon or by said Bacon while acting or pretending to act on behalf of said defendant, for the purpose of inducing said decedent to cancel said lease or to surrender his rights or any of them thereunder, or to sell to said defendant any of the lands covered by said lease for a price less than said lands were worth, or less than said decedent would have accepted therefor had he known that oil had been struck in said well, or for any purpose.

Deny that these defendants did not at any time prior to the consummation of the sale and conveyance described in Paragraphs 8 and 9 of said complaint, inform said decedent and his said wife that any oil had been encountered in the drilling of said well, and deny, upon and according to their information and belief, that said decedent and his said wife or either of them consummated the said sale and conveyance believing that said well was a dry hole or a failure or that defendant Murphy Oil Company had failed to find any oil in the drilling thereof.

Deny that either said defendant or his said wife was without any knowledge, information, notice and suspicion, or knowledge, information, notice or suspicion, that oil had been found in said well prior to the consummation of said sale and purchase, or of the falsity of such of the matters alleged in said complaint to have been represented and stated to said wife by defendant Murphy Oil Company by or through said Bacon as were in fact made, until the

18th day of February, 1918, or until any time later than the year 1906, and defendants allege, upon and according to their information and belief, that both said decedent and his said wife had been informed prior to the time of the consummation of said purchase and sale [114] and at the time of the said consummation believed that defendant Murphy Oil Company had not abandoned said well or determined to do so, and that the work of drilling said well continued until on or about November 27, 1904, and that some oil had been discovered and was known by defendants to have been discovered in said well before work thereon was suspended.

Deny that either of these defendants knew at any time prior to the consummation of said sale and purchase, that oil in paying quantities had been struck in said well or that said well was a successful oil well or had been drilled into paying or productive oil sand; and defendants allege that oil in paying quantities had not been struck in said well prior to the consummation of said sale, and that up to said time said well was not a successful oil well and had not been drilled into a paying or productive oil sand.

VII.

Deny that defendants or either of them purposely or otherwise concealed at any time from said Bastanchurys or either of them the fact of the striking in said well of any oil struck therein prior to the time of the making of the statements and representations which were in fact made by these defendants or either of them and are mentioned in Para-

graph 7 of said complaint, or prior to the time of the making of any such statement or representation, or the fact that both of these defendants, or either of them, knew that said well had encountered oil or had penetrated a productive or any oil sand prior to the time of the making of said statements and representations, or prior to the making of any of them; and deny that these defendants or either of them, for the purpose of rendering any such concealment the more effective or for any purpose, did at any time keep said well full of water [115] or any water therein covering the oil strata or any oil stratum penetrated by said well, or did, by any such means, prevent or seek to prevent the escape or flow from said well of oil and gas or oil or gass, or did cause sundry persons or any person who inquired as to whether oil had been encountered in said well to be told that the same was a dry hole or an unsuccessful well, or did conceal, by covering the same with brush, any traces or trace of oil which had escaped from said well, or did burn or cause to be burned at night or at any other time any scum of oil on the water flowing from said well, to the end that said Bastanchurys and any passerby might not see evidences around said well that oil had been struck therein, or for any such or similar purpose, or did commence or proceed with or complete the well designated No. 2 in said complaint prior to any resumption of work upon said well No. 1, or did any act whatever.

VIII.

Defendants admit that the well drilled by defendant Murphy Oil Company and designated in said complaint as well No. 2, was, on or about the month of September, 1906, so far finished or completed that the same was capable of producing and did thereafter, and before being drilled to any greater depth, produce large quantities of oil; and deny that at or about the time said well No. 2 was so finished, defendant Murphy Oil Company cleaned out well No. 1 or that following any such cleaning out and as a result thereof said well became a flowing well and thereafter produced great or any quantity of oil, and defendants deny that following the shut-down of well No. 1 occurring in November, 1904, work on said well was not resumed until after said well No. 2 first became a producing well; on the contrary, defendants allege that such work was resumed long prior to said event, and defendants deny that the work done upon [116] said well No. 1 following the resumption of such work, consisted of and amounted to nothing more than the cleaning out of said well No. 1.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer whether or not it was supposed or believed by said decedent until his death, or supposed or believed by said wife until February 18, 1918, that the defendants had, after the completion of said well No. 2, or at any time following the month of November, 1904, deepened said well No. 1, and bas-

ing their denials upon said ground, defendants deny that said decedent, until his death or at any time, supposed or believed that after the completion of said well No. 2, or at any time following November 1904, said well No. 1 had been deepened, and deny that his said wife supposed or believed, until February 18, 1918, or at any time, that after the completion of said well No. 2, or at any time following November 1904, said well No. 1 had been deepened.

Defendants deny upon and according to their information and belief that said decedent until his death or at any time supposed or believed that by the deepening of said well No. 1 following November 1904, oil was for the first time struck therein, and likewise deny that said wife supposed or believed, until February 18, 1918, or at any time, that by the deepening of said well No. 1 following the month of November 1904, oil was for the first time developed therein.

Deny, upon and according to their information and belief, that said decedent or his said wife was, at the time said conveyance was made to said Bacon, or at any time, subsequent thereto, without notice or knowledge that both of these defendants knew of the striking of any and all oil struck in said well No. 1 [117] during the year 1904 concurrently with or substantially concurrently with the happening of such event or events; and likewise deny that said decedent or his said wife was at any time subsequent to the year 1906, without knowledge and notice of the falsity of such of the matters alleged in said complaint to have been stated or represented

by said Bacon to said wife as were in fact false, or any of said matters.

IX.

Defendants allege that they have no knowledge, information or belief sufficient to enable them to answer any of the allegations contained in Paragraph 13 of said complaint, other than the recitals therein that Gaston A. Bastanchury is a son of said decedent and his said wife; also the allegation or recital that there was kept or exists or existed a log of said well No. 1 containing certain statements described in said paragraph, also the allegation that the alleged acts of fraud described in said complaint were not discovered until on or about February 18, 1918, and basing their denials upon said ground, defendants deny each and every of said allegations; other than said excepted recitals and allegations; defendants deny upon and according to their information and belief that said alleged acts of fraud or any of them which had any existence in fact or in reality remained undiscovered by said decedent or by his said wife until February 18, 1918; on the contrary, defendants allege upon and according to their information and belief that both said decedent and his said wife had knowledge or notice of all of the facts pointing to or involving said alleged acts of fraud as early as the year 1906; and answering said recitals or allegations concerning said alleged log, defendants allege that no log of said well No. 1 or contemporaneous history of the drilling thereof covering the whole drilling history of the said well [118] or any part thereof was kept or prepared

by or at the direction of these defendants or either of them, or by anyone, and deny that any record in the form of a log of said well or a history of the drilling operations thereon was prepared by or at the direction of these defendants or either of them, or by anyone, earlier than the year 1909.

X.

Defendants deny that during the year 1909, or at any time, a contract was entered into between defendant Murphy Oil Company and Standard Oil Company of California whereby the latter undertook the operation of said real property or any part thereof for the production of oil therefrom, and deny that defendant Murphy Oil Company ever sold 2240 acres of land or any part thereof to said Standard Oil Company.

Defendants admit that defendant Murphy Oil Company did, during the year 1913, sell and convey to said Standard Oil Company certain personal property and articles in the nature of personal property though affixed or appurtenant to the land, together with all of the petroleum oil, natural gas and kindred mineral substances in or under certain lands, including said 2240 acres, as well as other lands located in the said general district, and in and by the same transaction and instrument leased and let unto said Standard Oil Company of California for the term of forty years commencing the first day of December, 1913, all of said lands with the exclusive right to the possession of the same, subject to certain limitations in said instrument

prescribed, together with the exclusive right and privilege of prospecting and drilling for, developing, producing and removing petroleum oil, natural gas and kindred mineral substances in and from said premises during said term, for the price or consideration of $5,500,000, payable [119] from time to time within five years from said last mentioned date, and that said defendant in and by the same transaction and instrument reserved to itself a one-fourth part of the petroleum oil produced and saved by said Standard Oil Company on said premises in excess of 730,000 barrels in any one year during the first five years from said last mentioned date, and a one-fourth part of all the petroleum oil produced and saved by said Standard Oil Company on said premises after said date, also a one-fourth part of all kindred mineral substances, except gas, extracted and marketed by said Standard Oil Company from said premises.

Defendants allege that said transaction was single and entire and was not severable either as to said price or as to the royalty oil reserved as between said 2240 acre tract and the remainder of the lands covered by said transaction; deny that said defendant, by said transaction, agreed to sell to said Standard Oil Company its said royalty oil; deny that by said transaction said defendant reserved to itself any share of the gas which should be thereafter produced from said 2240 acre tract, but defendants admit that as a part of said transaction said Standard Oil Company agreed to pay to defendant Murphy Oil Company two cents for each 1000 cubic

feet of gas, measured on an eight-ounce base, produced and sold off the premises by said Standard Oil Company or used by said Standard Oil Company on other premises than those hereinabove described or in operations not pertaining to the drilling, developing or operation of the premises hereinabove described and not pertaining to the storage or transportation of the products produced from said premises, or in manufacturing or transforming said gas into some other product for either use or sale.

Defendants have no knowledge, information or belief sufficient to enable them to answer whether or not the proceeds [120] of sales of such royalty share of future production of the wells now existing upon said 2240 acre tract, together with such additional wells as may be hereafter and during the term of said lease drilled by said Standard Oil Company, together with the payments to which defendant Murphy Oil Company may hereafter become entitled in virtue of said undertaking or agreement by said Standard Oil Company on account of the future production of gas from said tract, will amount to the sum of $15,000,000 or more, and basing their denials upon said ground, defendants deny that said proceeds will amount to said sum or even to as much as $5,000,000.

Defendants deny that defendant Murphy Oil Company has obtained by means of any fraud and false and fraudulent concealments or representations or any fraud or wrong mentioned in said com-

plaint and of which said defendant is or was guilty, the sum of $5,000,000, or any other sum whatever.

XII.

Defendants deny that defendant Murphy Oil Company has paid over, transferred or turned over to the defendant Edmund W. Bacon, or that the latter has received any portion of the moneys or things of value received by said Murphy Oil Company from its dealings with said 2240 acres of land or any part thereof.

Defendants deny, upon and according to their information and belief, that the consent of said decedent to the transaction referred to in said complaint and of which the sale and conveyance described in Paragraphs 8 and 9 of said complaint was a part, was induced or obtained by the alleged false representations, statements and acts of these defendants in said complaint set forth, or any false representations, statements and acts of these defendants, and likewise deny that without said alleged false representations, statements and acts, or any of them, said [121] decedent would not have consented to said transaction, or would have withheld his consent as to any part thereof.

Defendants deny that said decedent, had he known and believed prior to said sale and conveyance that oil and oil sand had been struck in the drilling of said well No. 1, would not have sold said 2240-acre tract to the defendant Murphy Oil Company or cancelled said oil lease, or would have refused to join in carrying out the transaction above men-

tioned; and deny that if said decedent had had the fullest information concerning the condition of the prospects of said well No. 1, he would have refused to join in carrying out said transaction.

Defendants deny, upon and according to their information and belief, that at the time of the consummation of said transaction or at any time prior thereto said 2240 acres of land had any value, market or actual, in excess of $78,000.

SECOND DEFENSE.

Defendants, for another, separate and second defense to said complaint allege:

That the alleged cause of action set forth in said complaint is barred by the provisions of Section 318 of the Code of Civil Procedure of the State of California.

THIRD DEFENSE.

Defendants, for another, separate and third defense to said complaint allege:

That the alleged cause of action set forth in said complaint is barred by the provisions of Section 319 of the Code of Civil Procedure of the State of California. [122]

FOURTH DEFENSE.

Defendants, for another, separate and fourth defense to said complaint allege:

That the alleged cause of action set forth in said complaint is barred by the provisions of Subdivision 4 of Section 338 of the Code of Civil Procedure of the State of California.

FIFTH DEFENSE.

Defendants, for another, separate and fifth defense to said complaint, allege:

That the alleged cause of action set forth in said complaint is barred by the provisions of Section 343 of the Code of Civil Procedure of the State of California.

SIXTH DEFENSE.

Defendants, for another, separate and sixth defense to said complaint, allege:

That the alleged cause of action set forth in said complaint is barred by the provisions of Section 353 of the Code of Civil Procedure of the State of California.

SEVENTH DEFENSE.

Defendants, for another, separate and seventh defense to said complaint, allege:

That neither plaintiff nor any ancestor, predecessor or grantor of plaintiff, nor said decedent, or his said wife, has been seized or possessed of the premises conveyed to Edwin W. Bacon, as alleged in Paragraph 8 of the complaint, or any part of said premises at any time since the month of January 1905, but that defendant Murphy Oil Company has held and possessed the said premises [123] and every part thereof adversely to the pretended right, title and claim of plaintiff ever since said month of January 1905, under a claim of title in fee, exclusive of any other right.

That said possession and occupancy by said defendant of said premises and every part thereof has been, ever since the month of January 1905, peaceable, continuous, uninterrupted, exclusive, open, notorious and adverse to all the world, including the plaintiff herein and all other persons whatever.

That defendant Murphy Oil Company has so had and enjoyed the possession of said premises and every part thereof ever since the month of January 1905, under claim of title exclusive of any other right, founding such claim upon two instruments, to-wit: that certain conveyance made by Domingo Bastanchury and Maria Bastanchury and described in Paragraph 8 of said complaint, as being a conveyance of said premises, which said conveyance was, on the 4th day of January 1905, recorded in the office of the county recorder of the county of Orange, state of California, also that certain conveyance made by Edmund W. Bacon and Anna Bacon, and described in said Paragraph 8 of said complaint as being a conveyance of the premises in question, which last mentioned conveyance was, on the 13th day of November, 1907, recorded in the office of said county recorder.

That during the whole of said period of occupancy, to-wit: ever since the month of January 1905, and down to and including the present time, said defendant has cultivated and improved said premises in the usual maner and throughout said period said defendant has paid all the taxes, state,

county and municipal, which have been levied and assessed upon said lands and premises or any part thereof. [124]

EIGHTH DEFENSE.

Defendants, for another, separate and eighth defense to said complaint, allege:

That neither plaintiff nor any ancestor, predecessor or grantor of plaintiff, nor said decedent, or his said wife, has been seized or possessed of the premises conveyed to Edwin W. Bacon, as alleged in Paragraph 8 of the complaint, or any part of said premises at any time since the month of January 1905, but that defendant Murphy Oil Company has held and possessed the said premises and every part thereof adversely to the pretended right, title and claim of plaintiff ever since said month of January 1905, under a claim of title in fee, exclusive of any other right.

That said possession and occupancy by said defendant of said premises and every part thereof has been, ever since the month of January 1905, peaceable, continuous, uninterrupted, exclusive, open, notorious and adverse to all the world, including the plaintiff herein and all other persons whatever.

That during the whole of said period of occupancy of said premises, to-wit: ever since the month of January 1905, and down to and including the present time, said defendant has actually occupied the whole of said premises and has cultivated

and improved the same in the usual manner and throughout said period said defendant has paid all the taxes, state, county and municipal, which have been levied and assessed upon said land and premises, or any part thereof. [125]

NINTH DEFENSE.

For another, separate and ninth defense, defendants, upon and according to their information and belief, allege:

That both said decedent and his said wife had, as early as the year 1906, notice or knowledge that prior to the suspension of work upon said well No. 1 on or about November 27th, 1904, oil had been struck in said well in such quantity that the water overflowing said well carried particles or traces of said oil and that on or about said time there was installed upon said well a gate or cap, for the purpose of preventing, and which did for many months thereafter and until work was resumed upon said well, in fact prevent, any further overflow of water and oil from said well excepting at such times and to such extent as defendant Murphy Oil Company permitted the same by opening said gate or cap; also notice or knowledge that said defendant had not at any time abandoned said well; also notice or knowledge that oil flowed from said well from time to time during the years 1904 and 1905, and prior to any resumption of work on said well, and flowed therefrom immediately upon resumption of work thereon.

Defendants likewise allege that said decedent, his heirs, devisees and personal representatives, notwithstanding said notice and knowledge, omitted and failed to make any complaint to or demand upon these defendants or either of them on account of the alleged frauds described in said complaint, or by any action to assert or enforce any right which accrued to said decedent by reason of said frauds, until the commencement of this action, and further allege that by reason of said notice and knowledge and said omission and failure, plaintiff is debarred by laches from the relief prayed in the bill of complaint and from any relief in equity. [126]

TENTH DEFENSE.

Defendants for a further separate and tenth defense, allege:

That at all times prior to the successful bringing in of Well No. 2 mentioned in the complaint, in the year 1906, the premises conveyed to defendant Bacon as mentioned in said complaint, embraced in the tract leased to Simon J. Murphy by the lease dated April 1, 1903, and set forth in said complaint, were what was known as "wild-cat" territory, the oil-bearing character of which could not be determined without the risk of loss of great sums of money and the employment of much skill and labor, and the expenditure of much money without any certainty of success; that for a period of approximately ten years following the commencing of operations under said lease, and until the year 1913, de-

fendant Murphy Oil Company and its predecessor in interest, Simon J. Murphy, made diligent and constant effort, in the beginning to discover oil on said property, and thereafter, to develop the same as paying and commercially valuable oil land; that the development of said land for oil was at all times up to the year 1913 prosecuted with great difficulty and at great expense, and entailed the risk of loss of large sums of money, owing chiefly to the great depth to which it was necessary to drill in order to obtain oil, and owing to the great difficulties and many problems encountered in shutting off the water developed in the wells drilled; that in the year 1913, said defendant granted to the Standard Oil Company of California all of the petroleum oil, gas and other kindred mineral substances contained in or under said lands, as well as certain neighboring lands, and by the same instrument let and leased to Standard Oil Company all of said lands, for a term of forty (40) years from said date, for the purpose of enabling said lessee [127] to prospect and drill for, develop, produce and remove the petroleum oil, natural gas and kindred mineral substances in and from said premises during said term; that said Standard Oil Company thereafter continued the work of developing oil upon said lands, and sank many wells thereon and erected many buildings, appliances, compressors, filters and other structures thereon, until said premises, by reason of said development, were, at the time of the commencement of this action, producing daily many

thousands of barrels of oil and many millions of cubic feet of gas; that by reason of said operations of defendant Murphy Oil Company up to the year 1913, and of the operations of said Standard Oil Company since said time, the value of the lands conveyed to defendant Bacon as aforesaid has been enhanced from a value of Seventy-eight Thousand Dollars ($78,000.00) in the year 1904, to the present value of many millions of dollars; that of the facts in this separate defense alleged, said decedent, during his lifetime, and his heirs, devisees and personal representatives, ever since, as well as theretofore, as these defendants are informed and believe, and upon such information and belief allege, had full notice or knowledge; but defendants further allege that neither said decedent nor any of his heirs, devisees or representatives, otherwise than by the commencement of this action, ever protested against the development of said premises or any part thereof by defendant Murphy Oil Company or said Standard Oil Company, or ever made any complaint to or demand upon either of said companies respecting the rights or claims upon which this action is based, or any of said rights or claims, but on the contrary, for a period of approximately fourteen years, have stood by and acquiesced in the development of said lands by defendant Murphy Oil Company and said Standard Oil Company, notwithstanding [128] their notice or knowledge of the facts in the premises as hereinbefore alleged, and notwithstanding

their notice or knowledge of the facts and matters specified in the last preceding separate defense, all of the allegations of which preceding separate defense are hereby adopted and made a part of this defense as fully as though said allegations were set forth at length herein.

Defendants further allege that throughout the term of the lease for grazing purposes covering a certain two thousand (2,000) acres of the lands involved in this action and made by defendant Edmund W. Bacon and Annie Bacon, his wife, in favor of said decedent and his said wife, as alleged in said complaint, said lessees and their transferees or successors in the ownership of said leasehold estate, claimed and enjoyed the full benefit of said lease and paid the rentals which accrued thereunder, notwithstanding notice or knowledge then possessed by said decedent and his said wife as hereinbefore alleged, and thereby, as these defendants are informed and believe, and upon such information and belief allege, said conveyance made to defendant Bacon, and the sale in pursuance and in consummation of which said conveyance was made, was ratified and confirmed by said decedent and by his heirs, devisees and personal representatives.

Defendants further allege upon and according to their information and belief, that the very great appreciation of the value of the lands conveyed to defendant Bacon as aforesaid has been developed and established by and through the courage, skill and enterprise employed, financial risks as-

sumed, and efforts made, in the development of said lands by defendant Murphy Oil Company and said Standard Oil Company as hereinbefore set forth, and that neither plaintiff nor said decedent ever contributed to or participated in, in any way, the developing or establishing of [129] said increased value of said lands.

Defendants allege upon and according to their information and belief, that on or about the year 1913 a large number of shares of the capital stock of defendant Murphy Oil Company were sold by the then holder or holders thereof to purchasers who paid full value for the shares purchased by them, and who did not at said time, or at any time prior to the commencement of this action, have any knowledge or notice whatever that any fraud of any kind had been committed, or was by any one claimed to have been committed in connection with the transaction whereby defendant Murphy Oil Company acquired the lands conveyed to defendant Bacon as described in paragraph VIII of the above mentioned complaint, or any knowledge or notice whatever of any of the alleged rights or claims upon which said complaint is based; and further allege that the value of said shares at the time of said purchases depended chiefly upon absolute ownership by said Murphy Oil Company of the interest and title in and to said last mentioned lands then and now claimed by said defendant, also to the rights and interests created or reserved in its favor in and by said conveyance and lease made by and be-

tween said defendant and said Standard Oil Company, and that each of said purchasers in making the purchase so made by him in good faith, relied upon the apparent absolute ownership by said Murphy Oil Company of said interests, rights and titles.

Defendants further allege upon and according to their information and belief that by reason of facts herein alleged it would be inequitable to award plaintiff the relief prayed for in the complaint, or any relief in equity, and that plaintiff's remedy, if any she has, is for damages; also that by reason of said facts, plaintiff is estopped to claim any relief prayed for [130] in the complaint or any relief in equity.

WHEREFORE, defendants pray that plaintiff take nothing by her action and that defendants may recover their costs herein incurred.

BRADNER W. LEE,
BRADNER W. LEE, JR.,
KENYON F. LEE,
PILLSBURY, MADISON & SUTRO,
O'MELVENY, MILLIKIN & TULLER,
Attorneys for defendant
Murphy Oil Company.

OSCAR LAWLER,
Attorney for defendant
Edmund W. Bacon. [131]

State of California,
County of Los Angeles.—ss.

John H. Emmert being duly sworn, deposes and says: That the Murphy Oil Company in the

within-entitled action is a corporation, and that affiant is an officer thereof to-wit: the Vice-President, and makes this verification for and on behalf of said corporation:

That affiant has read the foregoing Answer and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated on information or belief, and as to such matters he believes it to be true.

JOHN H. EMMERT.

Subscribed and sworn to before me this 6th day of December, 1918.

[Seal] NELLIE LEMERT,
Notary Public in and for the County of Los Angeles, State of California. [132]

[Endorsed]: Filed Dec. 7, 1918. [133]

(Title of Superior Court and Cause.)

CONSENT TO JUDGMENT.

All and each of the parties above named hereby consent and request that there be forthwith made, given and entered in said action a Final Judgment generally to the effect that said plaintiff take nothing as against said defendant, Edmund W. Bacon and that said plaintiff have and recover from said defendant, Murphy Oil Company the sum of $1,200,000, as damages resulting from the alleged wrongful acts, conduct and transactions mentioned in the complaint on file in said action, and that none

of the said parties recover costs as against any other; said judgment to conform substantially to the terms and effect of the form of judgment hereto attached and marked "Exhibit A".

Dated, April 28, 1919.

MARIA BASTANCHURY,
As administratrix with the will annexed of the estate of Domingo Bastanchury, deceased.

BENJAMIN E. PAGE,
W. E. MITCHELL,
ARTHUR C. HURT,
HUNSAKER, BRITT & EDWARDS,
Attorneys for said plaintiff. [134]

MURPHY OIL COMPANY,
By John H. Emmert,
Vice-President.
[Seal] By J. T. F. Baeyertz,
Secretary.

BRADNER W. LEE,
BRADNER W. LEE, JR.,
KENYON F. LEE,
PILLSBURY, MADISON & SUTRO,
O'MELVENY, MILLIKEN & TULLER,
Attorneys for defendant,
Murphy Oil Company.

OSCAR LAWLER,
Attorney for defendant,
Edmund W. Bacon. [135]

(Title of Superior Court and Cause.)

JUDGMENT FOR PLAINTIFF.

The above entitled cause came on regularly for trial before said Court in Department 10 thereof on the 29 day of April, 1919, trial by jury having been duly waived, upon the complaint filed by plaintiff and the joint and several answer thereto of said defendants; and said plaintiff having upon said hearing waived and abandoned all of her claims to equitable relief or any character of relief other than damages for or on account of the wrongs alleged in said complaint, and having elected to seek and claim only a judgment for damages on account of said alleged wrongs; and it appearing that notwithstanding the issues and disputes raised by said pleadings that said plaintiff, in pursuance of authority conferred upon her by an order duly given and made by the Superior Court of the State of California in and for the County of Orange in the proceeding therein pending entitled "In the Matter of the Estate of Domingo Bastanchury, deceased", and wherein said Maria Bastanchury was appointed and is now acting as such administratrix, empowering her so to do, has agreed with said defendants upon terms of compromise and settlement of all claims and causes of action which said plaintiff claims arose out of or in connection with the alleged wrongful acts, conduct and transactions [136] mentioned in said complaint and in or over which said plaintiff has any interest or

power of control, and it appearing that said agreement provides for the giving and making in the above entitled action of a final judgment in favor of said plaintiff and against said defendant, Murphy Oil Company, for the sum of $1,200,000—as the damages caused by or resulting from said alleged wrongful acts, conduct and transactions, also that said judgment should determine and adjudge that said plaintiff take nothing as against said defendant Edmund W. Bacon; and it appearing by written stipulation executed by all of said parties and on file in said action that said parties have consented to the giving and making herein forthwith of a judgment substantially following a specified form upon which form this judgment is based; now, therefore, in consideration of the premises

IT IS HEREBY ORDERED that said plaintiff Maria Bastanchury as Administratrix as aforesaid, is entitled to have and do have and recover from said defendant Murphy Oil Company, a corporation, the sum of $1,200,000—as damages caused by or resulting from said alleged wrongful acts, conduct and transactions but that said plaintiff do not have or recover any sum or any relief from defendant Edmund W. Bacon, also adjudged that none of said parties is entitled to costs against any other.

Dated: April 29th, 1919.

GRANT JACKSON, Judge.

[Endorsed]: Filed Apr. 29, 1919. [137]

(Title of Superior Court and Cause.)

SATISFACTION OF JUDGMENT.

The plaintiff in the above entitled action hereby acknowledges to have received the sum of One Million Two Hundred Thousand Dollars ($1,200,000.) in full and entire satisfaction of the judgment made and entered therein on the.....day of April, 1919.

Dated: April 29, 1919.

MARIA BASTANCHURY,
As Administratrix with the will annexed of the Estate of Domingo Bastanchury, deceased.

BENJAMIN E. PAGE,
W. E. MITCHELL,
ARTHUR C. HURT,
HUNSAKER, BRITT & EDWARDS,
Attorneys for Plaintiff. [138]

State of California,
County of Los Angeles.—ss.

On this 29th day of April, A. D. 1919, before me, Nina Cleaver, a Notary Public in and for the said county and state, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, as Administratrix with the will annexed of the Estate of Domingo Bastanchury, deceased, known to me to be the person whose name is subscribed to the within instrument, and

acknowledged to me that she executed the same, as such administratrix.

In witness whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] NINA CLEAVER,
Notary Public in and for said county and state.

[Endorsed]: Filed Apr. 30, 1919. [139]

(Title of Superior Court and Cause.)

ORDER AUTHORIZING SETTLEMENT AND COMPROMISE.

Upon reading and filing the verified petition of Maria Bastanchury, administratrix with the will annexed of the last will and testament of Domingo Bastanchury, deceased, from which it appears that there is pending in the Superior Court of the County of Los Angeles a certain action wherein said administratrix is plaintiff and Murphy Oil Company, a corporation, and Edmund W. Bacon are defendants, and that, subject to the approval and authorization of this court, said administratrix and the defendants in said action have entered into an agreement of compromise and settlement thereof, upon the terms and conditions set forth in said petition; and evidence having been produced before the court in support of the allegations of said petition, the court now finds that all said

allegations are true; and it further appearing that said agreement of compromise and settlement is just and for the best interests of the estate of said deceased, and that all persons interested in said estate, either as heirs, devisees or legatees, have consented to, and approved of, said agreement of settlement, and have joined in said petition praying for an order authorizing and approving the same;

IT IS THEREFORE, ORDERED that said agreement of settlement and compromise, as set forth in said petition, be, and the same is hereby, in all respects approved; and that said administratrix be, and she is hereby, authorized and empowered to enter [141] into and carry out said agreement of compromise and settlement, and as such administratrix to execute and deliver to Murphy Oil Company, one of the defendants in said action, a release of the nature set forth in said petition for execution by her as such administratrix, and also any and all other instruments in writing which may be deemed necessary or proper to carry into effect and consummate said agreement of compromise and settlement.

Done in open court this 28th day of April, 1919.

Z. B. WEST,
Judge of said Court.

[Endorsed]: Filed Apr. 28, 1919. [142]

Recorded in Book M & O No. 34, page 18, Apr. 29, 1919.

[Endorsed]: Filed Apr. 28, 1919. [143]

(Title of Superior Court and Cause.)

PETITION OF ADMINISTRATRIX FOR AN ORDER AUTHORIZING HER TO COMPROMISE CLAIM AND SETTLE LITIGATION.

TO THE ABOVE NAMED COURT:

Your petitioner, Maria Bastanchury, as administratrix with the will annexed of the estate of said Domingo Bastanchury, respectfully shows:

1. Said Domingo Bastanchury died on or about July 21, 1909, in the County of Orange, State of California, he, said decedent, being at the time of his death a resident of said county and leaving estate therein. Said Domingo Bastanchury left a last will and testament dated October 30, 1893, wherein one Orel M. Goldaracena was named as executor, who, thereafter, to-wit, May 22, 1918, in writing renounced his right to act as executor of said will. June 18, 1918, your petitioner filed her petition with the clerk of this court for the admission of said will to probate, and the issuance to her of letters of administration with the will annexed of the estate of said decedent. Such proceedings were thereafter had in the matter of said estate that July 5, 1918, this court, by its order duly given and made, admitted said will to probate as the last will and testament of said decedent, and directed letters of administration with the will annexed to issue to petitioner upon her taking the oath required by law and giving bond as required by said order. Thereafter, and on the same day,

petitioner duly qualified by taking such oath and giving such bond, and thereupon the clerk of said court, under the seal thereof, on the 5th day of July, 1918, issued such letters of administration to your petitioner, which letters have not been revoked, and she ever since has been, and now is, the duly appointed, qualified and acting administratrix with the will annexed of the estate of said deceased. [144]

2. Thereafter, to-wit, August 28, 1918, your petitioner as administratrix with the will annexed of the estate of said Domingo Bastanchury, deceased, commenced an action in the Superior Court of the County of Los Angeles, State of California, which action is entitled "Maria Bastanchury, administratrix with the will annexed of the estate of Domingo Bastanchury, deceased, plaintiff, v. Murphy Oil Company, a corporation, and Edmund W. Bacon, defendants", which action is numbered and designated on the files of said court "B-66477". Reference is hereby made to the complaint in said action for further particulars as to the facts on which plaintiff's right to relief therein was based, and the nature and character of the relief prayed for therein, a copy of which complaint is hereunto annexed, marked "Exhibit A" and made a part hereof. Thereafter the defendants in said action filed their answer denying the allegations of the complaint. Said action is still pending and undisposed of.

3. Your petitioner is the widow of said Domingo Bastanchury, and Dominic J. Bastanchury, Gaston A. Bastanchury, Joseph F. Bastanchury and John B. Bastanchury are the only children of said Domingo Bastanchury, and, with your petitioner, are the only persons entitled to share in the estate of said Bastanchury, either as his heirs at law or under or by virtue of his last will.

4. After the filing of the answer in said action, as aforesaid, negotiations were entered into between your petitioner and the defendants in said action for the settlement and compromise thereof without further litigation, and April 25, 1919, an agreement of settlement and compromise was entered into between your petitioner and the defendants in the said action, subject to the approval of this court, the terms and conditions of which agreement are as follows, to-wit:

(1) Murphy Oil Company, a corporation, on or before April 29, 1919, shall pay to your petitioner the sum of six hundred thousand dollars ($600,000.00) in cash, and execute and deliver [145] to your petitioner, as administratrix, as aforesaid, its six (6) promissory notes in the sum of one hundred thousand dollars ($100,000.00) each, each bearing date of April 29, 1919, and payable at Los Angeles, California, respectively, on or before thirty (30) days, sixty (60) days, ninety (90) days, one hundred and twenty (120) days, one hundred and fifty (150) days and one hundred and eighty (180) days

after the date thereof, without interest prior to their maturity.

(2) In consideration of the payment of said sum of $600,000.00, and the execution and delivery of said notes, (a) petitioner shall secure an order of this court, upon this petition and the consent of your petitioner and all other parties interested in the estate of Domingo Bastanchury, whether as heirs at law, legatees or devisees, approving this agreement of compromise and settlement; (b) your petitioner, as administratrix of the estate of said Domingo Bastanchury, deceased, shall execute and deliver to the attorneys for the defendants in said action a release, acquittance and discharge of each of the defendants therein, and all other persons and corporations who have heretofore owned or claimed, or now own or claim, any interest through or under said Murphy Oil Company in or to any of the lands conveyed by said deed of December 15, 1904, from and of all claims or causes of action for damages, or otherwise, on account of the alleged frauds referred to in said complaint also all other like claims or causes of action on behalf of said estate which have arisen or accrued by reason of the alleged acts, conduct and transactions of any of the defendants mentioned in said complaint; (c) your petitioner, Maria O. Bastanchury, and said Dominic J. Bastanchury, Gaston A. Bastanchury, Joseph F. Bastanchury and John B. Bastanchury shall cause to be executed and delivered to the at-

torneys for the defendants in said action, [146] a release, acquittance and discharge of each of the defendants in said action, and also all other persons and corporations who have heretofore owned or claimed, or now own or claim, any interest, through or under said Murphy Oil Company, in or to any of the lands conveyed by said deed dated December 15, 1904, from and of all claims or causes of action for damages, or otherwise, on account of the alleged frauds referred to in said complaint, and also all other like claims or causes of action belonging to them or any of them, or in which they or any of them are interested, or which said estate, or the administratrix thereof, or any of them, claim, or might claim, to have arisen or accrued by reason of the alleged acts, conduct and transactions or any of them, mentioned in said complaint; which release shall contain an agreement of indemnity, and shall be in such form as shall be approved by the attorneys for the parties plaintiff and defendant in said action; (d) petitioner shall cause the said action pending in the Superior Court of the County of Los Angeles, to be dismissed, without costs to any of the parties thereto; or, if the defendants in said action shall so elect, petitioner shall join with the defendants therein in causing a judgment to be entered in said action in favor of the plaintiff for the sum of one million two hundred thousand dollars ($1,200,000.00), as dam-

ages on account of the frauds alleged in said complaint, but without costs, and, if said defendants shall elect to have such judgment entered, them, upon receipt of said sum of six hundred thousand dollars ($600,000.00) in cash, and said promissory notes, aggregating the further sum of six hundred thousand dollars ($600,000.00), plaintiff in said action shall forthwith cause satisfaction of said judgment to be entered of record.

5. Your petitioner further shows that it would require several years, and involve the estate herein in large expense, to prosecute said action so pending in the Superior Court of the County of Los Angeles to a final determination thereof; and, while your petitioner is advised and believes that she, as [147] plaintiff in said action, has a meritorious cause of action and should succeed therein, she, and all other parties interested in said estate, are desirous of settling and compromising said action upon the terms hereinabove set forth, and she alleges that said agreement of compromise and settlement is just, reasonable, and for the best interests of the estate and all persons interested therein.

WHEREFORE petitioner prays that an order may be made by this court authorizing and approving said compromise and settlement and authorizing your petitioner, as administratrix with the will annexed of said Domingo Bastanchury, upon receiving the consideration in this petition mentioned,

to execute and deliver such agreements, contracts and other instruments, as may be necessary to carry said agreement of settlement and compromise into effect, or, for such other order as may be proper in the premises.

MARIA BASTANCHURY
Administratrix with the will annexed of
Domingo Bastanchury, deceased,
Petitioner.

BENJAMIN E. PAGE & ARTHUR C. HURT,
Attorneys for Petitioner.

CONSENT TO THE GRANTING OF THE FOREGOING PETITION.

The undersigned, Maria O. Bastanchury, widow of Domingo Bastanchury, and Dominic J. Bastanchury, Gaston A. Bastanchury, Joseph F. Bastanchury and John B. Bastanchury, sons of Domingo Bastanchury, hereby join in the prayer of the foregoing petition, and do consent to, and request the court to make, an order as therein prayed for.

Dated April 25, 1919.

MARIA O. BASTANCHURY,
DOMINIC J. BASTANCHURY, [148]
GASTON A. BASTANCHURY,
[Seal] JOSEPH F. BASTANCHURY,
JOHN B. BASTANCHURY.

State of California,
County of Orange.—ss.

On this 26th day of April in the year one thousand nine hundred and 19 A. D. before me Ruby Esmay, a Notary Public in and for said County, residing therein, duly commissioned and sworn, personally appeared Maria O. Bastanchury, Dominic J. Bastanchury, Gaston A. Bastanchury, Joseph F. Bastanchury, John B. Bastanchury, personally known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Notarial Seal] RUBY ESMAY,
Notary Public in and for the County of Orange, State of California.

State of California,
County of Orange.—ss.

Maria A. Bastanchury, being first duly sworn, says: That she is the person named as petitioner in the foregoing petition; that she has read said petition, and knows the contents thereof, and that it is true of her own knowledge, except as to the matters therein stated upon information or belief, and as to those matters she believes it to be true.

MARIA BASTANCHURY.

Subscribed and sworn to before me this 26th day of April, 1919.

[Notarial Seal] RUBY ESMAY,
Notary Public in and for the County of Orange, State of California. [149]

(Title of Superior Court and Cause.)

WHEREAS, in and by the complaint on file in the above entitled action said plaintiff states and asserts against said defendants various alleged causes of action and alleged rights or claims to relief, all based upon certain fraudulent act or conduct alleged to have been heretofore committed by or on behalf of said defendants; and

WHEREAS, each of said defendants has denied and disputed at all times heretofore and does now deny and dispute each and every of said charges, also the existence at this time or at any time of any liability or duty of any kind whatsoever, either legal or equitable in favor of said plaintiff or of any other person whatsoever claiming under or through said decedent which has heretofore arisen out of or could hereafter arise out of or directly or indirectly in connection with the acts, conduct and transactions mentioned in said complaint, or any of them, in so far as said acts, conduct and transactions ever had any existence in reality or in fact; and

WHEREAS, nevertheless, said plaintiff, acting with and upon the consent and approval of each of the undersigned, has agreed with said Murphy Oil Company upon a compromise and settlement of all [150] of said disputed rights, claims, causes of action and liabilities, including especially and primarily all claims or causes of action for damages on account of said alleged fraudulent acts and transactions which are stated or asserted in said complaint or might be therein or otherwise claimed or asserted by said Administratrix against said defendants, or either of them; and

WHEREAS, said Murphy Oil Company has heretofore paid to said Administratrix, partly in cash and partly by the execution and delivery of its promissory notes the sum which said Administratrix undertook by said agreement to accept in compromise and settlement of all of said rights, claims and causes of action.

NOW, the undersigned, Maria Bastanchury, Dominic J. Bastanchury, Gaston A. Bastanchury, Joseph F. Bastanchury, and John B. Bastanchury, being all of the heirs at law, as well as all of the legatees of said decedent, in consideration of the payment so made by said Murphy Oil Company to said Administratrix, do hereby jointly and severally release, acquit, and discharge each of the defendants above mentioned, also all other persons and corporations who have heretofore owned or claimed or now own or claim any interest through

or under said Murphy Oil Company in or to any of the lands conveyed by that certain deed dated December 15, 1904, a copy of which is set forth in paragraph VIII of said complaint, from and against all claims or causes of action for damages on account of said alleged fraud, involved or referred to in said complaint, also all other like claims or causes of action belonging to the undersigned or any of them or in which they or any of them are in any manner interested which said Administratrix and the undersigned or any of them claim or might claim to have arisen or accrued by reason of the alleged acts, conduct and transactions or any of them mentioned in said complaint. [151]

And in consideration of said compromise and settlement of said alleged claims for damages, the undersigned do hereby jointly and severally release, acquit and discharge each of the releasees above named or described from and against all other claims or causes of action involved or referred to in said complaint, also all other rights, claims, or causes of action of whatsoever nature which said Administratrix and the undersigned, or any of them, claim or might claim as against said releasees or any of them or in which said Administratrix and the undersigned or any of them claim or might claim to be interested, which arose or accrued or which might be claimed to have arisen or accrued by reason of said alleged acts, conduct and transactions or any of them.

Mr. Ben R. Meyer, having acted as intermediary between the respective parties in the

course of the negotiations leading up to said compromise and settlement, the undersigned and each of them hereby declare and acknowledge that throughout said negotiations it has been understood by the undersigned that said Meyer expected to be compensated for his services as such intermediary in part by said Murphy Oil Company and in part by said Administratrix and the undersigned.

The undersigned, jointly and severally, hereby agree to indemnify and protect the releasees above mentioned and each of them from and against all rights, claims and causes of action hereinbefore mentioned, in respect of all liabilities involved therein or based thereon and now or hereafter existing or claimed to exist in favor or for the benefit of any persons or person, corporations or corporation, claiming or who shall claim through or under Domingo Bastanchury, deceased, as creditor or otherwise, or through or under any of the [152] undersigned, also from and against all loss, costs and attorneys' fees hereafter suffered or borne by said releasees or any of them on account of or in respect of said liabilities or any of them.

WITNESS our hands this 26th day of April, 1919.

MARIA BASTANCHURY,
DOMINIC J. BASTANCHURY,
GASTON A. BASTANCHURY,
JOSEPH F. BASTANCHURY,
JOHN B. BASTANCHURY. [153]

(Title of Superior Court and Cause.)

RECEIPT AND AGREEMENT TO SATISFY JUDGMENT.

Plaintiff in the above entitled action hereby acknowledges receipt of the sum of One Million Two Hundred Thousand Dollars ($1,200,000.) in full and entire satisfaction of the judgment made and entered in the above entitled cause on the .....day of April, 1919, and hereby agrees and undertakes to cause to be entered in said action full and entire satisfaction of said judgment whensoever thereunto requested by the defendants in said action.

MARIA BASTANCHURY,
As Administratrix with the will annexed of the Estate of Domingo Bastanchury, deceased.

[Seal] BENJAMIN E. PAGE,
W. E. MITCHELL,
ARTHUR C. HURT,
HUNSAKER, BRITT & EDWARDS,
Attorneys for Plaintiff. [156]

State of California,
County of Los Angeles.—ss.

On this 29th day of April A. D., 1919, before me, Nina Cleaver, a Notary Public in and for the said County and State, residing therein, duly commissioned and sworn, personally appeared Maria Bastanchury, as Administratrix with the Will annexed of the Estate of Domingo Bastanchury, de-

ceased, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that she executed the same as such Administratrix.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

[Seal] NINA CLEAVER,
Notary Public in and for said County and State. [157]

EXHIBIT "C."

Sheet No..... Account No. 109-a
New Ledger a/c 153

S. & E. LEGAL-BASTANCHURY A/C

Date 1918	Items Debits	Credits	From	Debits	D C	Credits	A C	Balance
	Amounts Brought Forward							
Oct. 25	Transf from S & E Legal		J808	399.28				
	PI4940—B. W. Lee	19.60						
	" 5076 "	9.30						
	" 5261½ 10 Copies Oil World	1.00						
	" 5283 B. W. Lee	306.61						
	C743 Conf with JHE a/c trip to Warren, Pa., to interview Johnson 5/6-5/11	62.77						
		399.28						
	" Portion of PI5300 work on lawsuit maps		J808	93.00				
22	Ck 19521 J H Emmert		C748	500.00				
25	" 19252 W S Lane—Chauffr for JHE		" "	20.00				
31	Trips to LA. to see Mr Lee L L Bauers time etc		J814	15.65				
	" Engineers services in connection with maps		PI5339	225.00				
	" B. W. Lee services		" 5341	1,250.00				
	" Tax Bonds 5 maps (Nat'l Surety Co.)		" 5349	40.00				
	" Transf from Special Exp.		J815a	164.98				2,707.91

	PI5234—Chauffer services for WCM & JHE 124.98					
	PI5236 Work on record maps 15.00					
	C738 Recording maps 25.00					
		164.98				
Nov.	29 Ck 19940—Oscar Lawler		C761	2,500.00		
	7 " 19659—W. S. Lane—Exp a/c for J H Emmert		"752	8.10		
	11 " 19711 B. W. Lee Fee		"754	5,000.00		
	" " 19712 Oscar Sutro Fee		" "	5,000.00		
	" " 19713 E. E. Millikin Fee		" "	5,000.00		
	" " 19714 Oscar Lawler Fee		" "	5,000.00		
	30 B. W. Lee transferred to a/c Payable		"817		5,000.00	
	" Map work—J. M. Kemerer		PI5401	403.50		
	" B. W. Lee—Atty's fees		" 5405	5,531.01		
	" Atty's expense		" 5417	501.25		26,651.77
Dec.	4 Ck 20044 to J. H. Emmert		C765	500.00		
	Amounts Carried Forward			32,151.77	5,000.00	

M1 [159]

EXHIBIT "C."

Account No. 109a Sheet No.....

S. & E. LEGAL-BASTANCHURY A/C

Date 1918	Items Debits	Credits	From	D C Debits	Credits	A C Balance
	Amounts Brought Forward			32,151.77	5,000.00	M1
Dec.	4 Ck 20046 Oscar Lawler		C765	1,500.00		
	19 " 20211 " "		" 770	1,000.00		
	3 Trip to LA to see Mr. Lee		JC172	1.40		
	31 Map work		PI5468	39.00		
	" Oscar Lawler Services		" 5473	2,000.00		
	" Mr. Lee a/c Millikin bill		" 5477	1,134.17		
	" Time & Serv. re interviews with Johnson on 10/28 & 10/30 & 11/4		" 5479	75.00		32,901.34
	" Roy Oil Exp.		J832		32,901.34	
				37,901.34	37,901.34	

M2 [160]

Sheet No..... Account No. 153

EXHIBIT "D."

LEGAL-BASTANCHURY A/C

Old Ledger a/c 109-a

Date 1919	Items Debits	Credits	From	Debits	D C	Credits	A C	Balance
Jan. 8	Lunch & Garage bill on 3 LA trips		JC173	4.10		√		
31	Engineer Services coloring maps etc.		PJ5534	14.00		√		
"	Bradner W. Lee & Louis Baar services		" 5537	5200.50		√		
"	Oscar Lawler—Atty fees		" 5538	8000.00		√		
"	E. E. Millikin " "		" 5542	5000.00		√		18218.60
				18218.60	*			
Feb. 7	T G Sutherland Expenses		JC174	5.28		√		
17	" " Hotel and meals		" 175	5.00		√		
28	Oscar Lawler—Atty fees		PJ5593	3500.00		√		21728.88
				21728.88	*			
Mar 28	Expense—A. Schinneller & T. G. Sutherland		JC176	2.60		√		
31	Oscar Lawler—Atty' fees		PJ5662	5000.00		√		
				26731.43	*			
Apr 30	Bradner W. Leo services		" 5736	44.50		√		
"	Oscar Lawler "		" 5738	5596.36		√		
"	Pillsbury, Madison & Sutro services		" 5754	549.60		√		9690.46
"	Oscar Sutro—Atty' fee		" 5767	3500.00		√		36421.94
				36421.94	*			
May 5	Poste, Postage, Clock rental See a/c 154		JC177	XXX				
"	Lunch & parking garage & 5 copies Wh. News		" "	2.25		√		
1	Documentary Stamps MFT note		C821	120.00		√		
2	T G Sutherland services		" "	1000.00		√		
"	A Schinneller "		" "	1000.00		√		
"	Lew Bauer "		" "	1000.00		√		
10	Ray Frich "		" 822	1000.00		√		
21	Jas. L. Johnson "		" 828	500.00		√		
31	B W. Lee Atty fees.		PJ5805	15000.00		√		
"	" " (W. R. Poundstone)		" "	500.00		√		
"	Oscar Lawler Atty fees		" 5806	15000.00		√		
"	" " " expenses		" "	2041.17		√		
"	E. E. Millikin "		" 5812	304.00		√		
"	Ben R. Meyers Services		" 5814	35000.00		√		
"	O'Melveny, Millikin & Fuller—fees		" 5816	15000.00		√		
"	" " " " expense		" "	336.76		√		88158.82
"	Pillsbury, Madison & Sutro "		" 5819	354.64		√		124580.76
June 30	Misc charges B. W. Lee		" 5896	16.62		√		
	Amounts Carried Forward			124597.38				N1

[161]

*Pencil extensions or additions.

EXHIBIT "D."

Account No. 153 Sheet No.....

LEGAL-BASTANCHURY A/C

Date 1919	Items Debits	Credits	From	Debits	D C	Credits	A C	Balance
	Amounts Brought Forward			124597.38				582.17
June 30	Pillsbury, Madison & Sutro exp a/c services		PJ5885	565.55		√		125162.93
				125162.93 *				
July 31	Oscar Lawler		" 5941	300.00		√		125462.93
				125462.93 *				
Aug 31	Pillsbury, Madison & Sutro fees		" 6022	45000.00		√		170462.93
Sept 30	Miller, Smith, Caufield, Paddock & Perry		" 6084	347.46		√		170810.39
				170810.39 *				
Oct 31	O'Melveny, Millikin & Fuller		" 6159	66.85		√		170877.24
Dec 31	Rev & Exp Ray Oil		J913			170877.24		
				170877.24		170877.24		
	Amounts Carried Forward							N2

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Sheet No..... Account No. 196

BASTANCHURY ACTION (E)

Date 1919	Items Debits	Credits	From	Debits	D C	Credits	A C	Balance
	Amounts Brought Forward							
Apr 26	Note to Murphy Family Trusts		J868	600000.00				
" "	" " Maria Bastanchury Admx		"869	600000.00				120000000
Dec 31	Rev & Exp Roy Oil		"913			1200000.00		
				1200000.00		1200000.00		
								O1

[163]

*Pencil extensions or additions.

INDENTURE
of Conveyance, Transfer and Sale
and of Lease

MURPHY OIL COMPANY
and
STANDARD OIL COMPANY

Dated December 1, 1913. [164]

State of Michigan,
County of Wayne.—ss.

I, Walter P. Clark, a Notary Public in and for the said County of Wayne and State of Michigan, do hereby certify that I have compared the attached copy of Indenture of Conveyance, Transfer and Sale and of lease, dated December 1, 1913, made between Murphy Oil Company and Standard Oil Company, which said original is in the office of John H. Emmert, Vice-President of said Murphy Oil Company, 2204 Penobscot Building, Detroit, Michigan, and I do certify that the said attached copy is a true, exact, complete and perfect copy of said original.

In witness whereof, I have hereunto set my hand and seal this 26th day of September, A. D. 1928.

[Seal] WALTER P. CLARK,
Notary Public, Wayne County, Michigan.

My commission expires April 3, 1929.

State of Michigan,
County of Wayne.—ss.

John H. Emmert, being duly sworn, deposes and says that he is an officer, to-wit, Vice-President of the Murphy Oil Company and that as such he has custody of the original Indenture of Conveyance, Transfer and Sale and of Lease, dated December 1, 1913, between Murphy Oil Company and Standard Oil Company, and that he has compared the attached copy of said Indenture with the original thereof and that the said attached copy is a true, exact, complete and perfect copy of said original.

And further, deponent saith not.

JOHN H. EMMERT.

Subscribed and sworn to before me this 26th day of September, 1928.

[Seal] WALTER P. CLARK,
Notary Public, Wayne County, Michigan.
My commission expires April 3, 1929. [165]

THIS INDENTURE, of conveyance, transfer and sale and of lease, made at San Francisco, California, this first day of December, 1913, by and between MURPHY OIL COMPANY, a corporation organized and existing under the laws of the State of California, the party of the first part, the grantor, vendor and lessor, herein called the first party, and STANDARD [Parties.*] OIL COMPANY, a similar corporation organized and existing under the laws of the State of California, the party of the

*Words set in brackets indicate marginal notes appearing in the Indenture.

second part, the grantee, purchaser and lessee, herein called the second party,

WITNESSETH:

Payments.

The second party, in consideration of the conveyance [Payments.] and sale and of the lease all as hereinafter set forth and independently of and in addition to the royalties and other considerations in this instrument herein and hereinafter provided has paid to the first party the sum of ten dollars ($10.00) and other sums and other considerations, the receipt of which by the first party is hereby acknowledged, and agrees to further pay independently of the said royalties and said other considerations to the first party the sum of one million dollars ($1,000,000.00) on or before four (4) months from the date hereof with interest at the rate of five per cent per annum from date until paid; also the further sum of two hundred and fifty thou- [166] sand dollars ($250,000.00) on or before fifteen (15) months from the date hereof; also the further sum of two hundred and fifty thousand dollars ($250,-000.00) on or before eighteen (18) months from the date hereof; also the further sum of two hundred and fifty thousand dollars ($250,000.00) on or before twenty-one (21) months from the date hereof; also the further sum of two hundred and fifty thousand dollars ($250,000.00) on or before twenty-four (24) months from the date hereof; also the further sum of five hundred thousand dollars ($500,000.00)

on or before thirty (30) months from the date hereof; also the further sum of five hundred thousand dollars ($500,000.00) on or before thirty-six (36) months from the date hereof; also the further sum of five hundred thousand dollars ($500,000.00) on or before forty-eight (48) months from the date hereof; and also the further sum of five hundred thousand dollars ($500,000.00) on or before sixty (60) months from the date hereof. The first party shall not be entitled to interest on any of the payments to be made as hereinabove set forth (except on the first of said payments) prior to the date on which said payments are due as hereinabove set forth and the second party covenants that it will without delay and well and truly make all of the said payments at the time herein provided. All of said payments shall be paid to the first party at its principal place of business in East Whittier, California, or at such place or bank in California as previously designated by writing addressed to the second party from time to time by the first party, or [167] failing such designation the second party shall make such payments to the credit of first party at a bank of good standing in California, and promptly notify the first party thereof.

It is further stipulated and agreed that all of said payments and also all other cash payments for royalties herein provided to be paid under this instrument, and all other rents which are herein provided to be paid in cash shall be paid in standard gold coin of the United States of America and that

by the word "dollar" wherever used in this instrument is meant that each dollar shall be of the standard weight and fineness observed at the Mint of the United States and fixed by its laws at the time said payment is due.

And it is further expressly understood and agreed by and between the first party and second party that no acceptance by the first party of any currency, legal tender, checks, coin, money or value whatever except standard gold coin of the United States of America as hereinbefore specified in payment of any installment or installments of rent shall be construed to be a waiver on the part of the first party of the right, after thirty (30) days' notice to second party, to demand the payment of any other unpaid installment or installments of rent or other cash payment herein provided in standard gold coin of the United States of America as hereinbefore specified.

CONVEYANCE, TRANSFER AND BILL OF SALE.

The first party, for and in part consideration of the payments made and by the second party to be made as [168] [Bill of Sale of all Property; Exceptions.] hereinbefore set forth, and of the other considerations paid and delivered by the second party hereinbefore referred to, has granted, bargained, sold, conveyed, transferred, assigned, and set over, and does hereby grant, bargain, sell, convey, transfer, assign and set over unto the second

party absolutely, and for and as the sole property of the second party, and free and clear of all encumbrances, and with full warranty of the title of the first party thereto, all the property of every nature whatsoever (inclusive of all fixtures and appurtenances and exclusive only of the land itself and such buildings and personal property as may be expressly reserved unto and by the first party according to an inventory to be signed by the parties hereto), in or on, about or between the four parcels herein described or any of them, or thereunto belonging or in any manner appertaining, which has heretofore been employed or used or installed for use or owned by the first party in connection with or between any of the four parcels of land herein described or in the drilling or operation of the premises herein described or in the development, production, marketing or transportation of oil; including all oil wells and their appurtenances, buildings and other structures, camps, camp houses and their furnishings and fittings, machinery, pumps, tanks, tankage, tools, supplies, horses, and personal property of every kind, tracks, switches, loading racks, and all other equipment or appliances, together with oil, gas and water pipe lines, telephone and telegraph lines (except such water lines as are reserved to the first party in the [169] inventory hereinbefore referred to), and rights appurtenant thereto, and together with water to which the first party is entitled as the holder of ten shares of water stock or as the owner of the lands herein

described, but only so much of such water as may be [Water.] required by the second party in the economical and reasonable operation of the premises hereinafter leased, as herein provided, and all rights of way for such pipe lines and telephone and telegraph lines, and [Rights of way.] other rights of way and easements, between any of the four parcels herein described, and any one or more of the other of said parcels; it being the intent hereof that the second party shall own and have all and singular said property and rights and privileges belonging to, possessed or used or installed for use by the first party in the conduct of its oil business including all property possessed or used or installed for use by the first party, in the operation of the premises herein described and in the development, production, transportation and marketing of oil therefrom or from any part thereof. Nothing in this instrument contained, however, shall be so construed as to obligate the first party to transfer or convey to the second party any part or portion of said land itself nor shall this instrument or any provision herein contained be so construed as to operate as a transfer or conveyance from the first party to the second party of any part or portion of said land itself. [170]

LEASE.

The first party for and in part consideration of the payments made and by the second party to be made as hereinbefore set forth and of the other considerations paid by the second party hereinabove

referred to and of the covenants, conditions and agreements herein contained by the second party to be duly and faithfully kept and performed, and subject to the limitations [Mineral Grant.] herein contained, has granted, bargained, sold and conveyed, and does by these presents grant, bargain, sell and convey, unto the second party all the petroleum oil, natural gas and kindred mineral substances in and under the premises hereinafter described, as parcels one and two, and has leased and let, and by these presents does lease and let unto the second party, its successors and assigns, the said [Lease.] premises for a term of forty (40) years from the date hereof, with the exclusive right to the possession of the premises (except as herein otherwise expressly [Term.] provided with reference to the first party), and with the exclusive right and privilege of prospecting for, drilling for, developing, producing and removing petroleum oil, natural gas and kindred mineral substances in and from said premises during said term.

Said parcels one and two are situate in the Counties of Orange and Los Angeles, in the State of California, and are more particularly described as follows, to wit:

PARCEL ONE:

[Parcel One East Whittier lands.]

Being all of blocks three (3), six (6), seven (7), ten (10) and twelve (12) of Tract No. 159 in the [171] County of Los Angeles, State of California, as recorded in Map Book 14, pages 14 and 15, and Map

Book 17 pages 190 and 191 of Records of said county; and those portions of blocks four (4), five (5) and (9) of said Tract 159, lying northeasterly of a line formed by projecting the center line of blocks eleven (11) and twelve (12) of the Subdivision of the East Whittier Rancho, as shown upon a map recorded in Book 43 pages 15 and 16 Miscellaneous Records of Los Angeles County, in a southeasterly direction to a point of intersection with the common boundary of blocks five (5) and seven (7) of said Tract 159. The area of the fractional blocks four (4), five (5) and nine (9) above described being respectively five hundred seventy-three and thirty-five hundredths (573.35) acres, more or less; forty-five and twenty-hundredths (45.20) acres, more or less; and five and six hundredths (5.06) acres, more or less.

Also, that portion of block four (4) of said Tract 159 described as follows:

Beginning at a 6″x6″ Redwood Post in the northerly line of Sixth street, distanct south fifty-six degrees (56°) nineteen minutes (19′) east one hundred ninety (190) feet from the southerly corner of Block nine (9) Tract 159 as recorded in Map Book 17 pages 190-191 Records of Los Angeles County; thence north thirty-three degrees (33°) forty-one minutes (41′) east six hundred thirty (630) feet to a 6″x6″ Redwood Post; thence south fifty-six degrees (56°) nineteen minutes (19′) east one thousand sixty-six (1066) feet; thence south sixty degrees (60°) fifty-four minutes [172] (54′)

west four hundred fifty-three seven-tenths (453.7) feet; thence south eighty-seven degrees (87°) fifty-four minutes (54′) west three hundred eighty-seven and two-tenths (387.2) feet, more or less, to a point in the northerly line of Sixth street extended; thence north fifty-six degrees (56°) nineteen minutes (19′) west five hundred forty-five (545) feet more or less, to the point of beginning, containing twelve and fifty-seven hundredths (12.57) acres, more or less.

PARCEL TWO:

[Parcel Two Rancho Los Coyotes Lands.]

In Los Angeles County, State of California, described as follows, to wit:

(a). The north half and the southwest quarter of section thirteen (13), township three (3) south, range eleven (11) west, S. B. B. & M., in the Rancho Los Coyotes.

(b). In Orange County, State of California, described as follows, to wit:

All of section seventeen (17), eighteen (18), nineteen (19) and twenty (20) (except the north quarter of section seventeen (17) and the southwest quarter of section nineteen (19)), township three (3) south, range ten (10) west, S. B. B. & M., in the Ranchos Los Coyotes.

[Other rights Granted.]

Together with the right exclusive of all others (except as herein otherwise expressly provided with reference to the first party) of entering upon said premises at all times with the right of ingress, egress

and regress to and from the same for the purpose of pros- [173] pecting for, drilling for, developing, producing, storing and removing such petroleum oil, natural gas and kindred mineral substances on, in and from said premises, with the right to construct, maintain and use thereon all buildings, tanks, machinery, plant, equipment and apparatus, pipe lines for the transportation of oil, gas and water, telephone and telegraph lines, and with all rights of way therefor, tankage and other structures and facilities, for the prospecting of, drilling on, developing from, producing from, transportation from and storage on said premises of petroleum oil, natural gas and kindred mineral substances whether produced or obtained on or from said premises or elsewhere; provided, however, that such substances produced or obtained elsewhere may be stored on said leased premises at such locations as may be [Water.] selected by and with and upon the consent of first party in writing first had and obtained; and for the distribution of water for use only upon said premises; the first party reserving to itself the one-fourth (¼) part of all the petroleum oil produced and saved by the second party on said premises in excess of seven hundred and thirty thousand (730,000) barrels in any [Royalty reserved.] one year during the first five (5) years from the date hereof, and the one-fourth (¼) part of all the petroleum oil produced and saved by the second party on and from said premises after five (5) years from the date hereof, and the one-fourth (¼) part of

all kindred mineral substances (except gas) extracted and marketed from said premises by the second party. [174]

[Existing leases.]

The rights and privileges herein granted are taken by the second party subject to all existing rights of way, licenses and easements over, across and upon said premises and subject to all existing leases of surface rights in and to portions of the premises, all of which leases will expire on or before the 1st day of January, 1915.

[Second party to have free use of oil, gas and water.]

The second party may, while this instrument remains in force, or while it is occupying any part of the premises pursuant hereto, develop water on the premises and shall have the free use during said time of such oil, gas, and water as it may develop or find upon said premises, together with the right to take the same at such times and in such manner as it may deem fit, but only for its necessary and economical operations under the terms of this instrument, and with as little waste as may be consistent with economic and reasonable use, on, to, from or between said parcels One, Two, Three and Four herein described, or either or any of them, in prospecting for, drilling for, developing, producing, storing or transporting petroleum oil, gas or kindred mineral substances, and for domestic use on any of the parcels herein described.

[Reservations by first party.]

The first party expressly reserves to itself, its agents, servants, employees or other representative or representatives, the right and privilege of entering upon said real property and the whole thereof at any and all times for the purpose of inspecting the same and inspecting the operations of the second party thereon, and (subject always and subordinate to the right of [175] the second party to operate and use the premises as hereinafter provided) also reserves the right and privi- [Inspection of premises.] lege at all times freely and uninterruptedly to use in such manner as to it may seem fit, the surface of the premises herein leased, and to farm, pasture, cultivate and remove the crops and other farm products and [Surface rights.] all trees growing upon, from and off the surface of said leased premises. All water not taken or used by [Water reserved to first party.] the second party, as and for the purposes herein permitted, is hereby expressly reserved by the first party to itself, together with the right to take and use the same in such manner and at such times as the first party may see fit and for its own use and benefit, together with the right to construct, maintain and keep in repair, but always at first party's own expense, all pipes, [Pipe lines; Reservoirs.] pipe lines, reservoirs or other closed conduits for the conservation and transportation of such water as to the first party may seem necessary or convenient [Reservations subordinate to second party's rights.] All

use by the first party of the surface of said land including the right of the first party herein reserved to farm, pasture, cultivate and remove the crops and other farm products and trees, and to conserve and transport water and construct and maintain pipes, pipe lines, reservoirs and other closed conduits, shall at all times be with as little interference with the operation of the second party hereunder as possible and shall be subject and subordinate to the rights of the second party herein granted to drill, develop, extract, store, transport and remove petroleum oil, gas or kindred mineral substances from the premises, or to develop and use water, and shall not inter- [176] fere with such rights whenever the second party shall desire to exercise the same.

[Second party held harmless from claims for damage from first party's use of surface rights or handling of royalty oil or to first party's agents or property.]

The first party covenants and agrees to hold the second party harmless from any and all claims and demands of any nature whatsoever which may be made against the second party for damages or injuries suffered, or claimed to have been suffered, whether the same be personal injuries or injuries or damage to property arising out of, or connected with the farming operations of the first party or other use by the first party of the surface rights of the premises herein leased to the second party, or of any part thereof or the use of any of the

other rights herein reserved to the first party or arising out of, or connected with, the taking, storing, use, or transportation by the first party of water, or petroleum oil or gas or kindred mineral substances, and will likewise save and hold second party free and harmless of and from all costs, expenses and counsel fees which second party may be compelled to pay out in defending itself and its property from any such claim or claims. The first party further covenants and agrees that any and all farming operations on, or other use of the surface rights of, the premises herein leased to the second party, or the taking, storing, use or transportation by the first party of water or petroleum oil or gas or kindred mineral substances, shall be at the sole risk of the first party, or of any person holding or acting under the first party in that behalf. The first party covenants and agrees that the second party shall not be liable to the first party for pollution of water, or damage [177] to crops, livestock, improvements or other property, by seepage, overflowing or leakage of oil or water, or by breakage or bursting of pipes or otherwise, or for any damage to crops, livestock, improvements, or other property, of any nature whatsoever, whether the same be fixtures or personal property, belonging to the first party and situate on the four parcels herein leased to the second party, or on any of them, and covenants and agrees to hold the second party harmless from any and all claims and demands of any nature whatsoever which may be made against

the second party for damages or injuries suffered, or claimed to have been suffered, in respect of such crops, livestock, improvements, or other property, whether the same be fixtures or personal property, or in respect of personal injuries suffered, or claimed to have been suffered, by any person who may be on or about any of the four parcels herein described, in connection with the farming operations or other use of the surface rights thereof of the first party, or in connection with the taking, storing, use or transportation by the first party of water or petroleum oil or gas or kindred mineral substances, and whether said damages or injuries may have been, or may be claimed to have been sustained or caused by reason of, or in connection with, the operations of the second party pursuant to this instrument, or its possession or use of the premises herein leased or of the property herein sold to it, or of the rights or rights of way herein granted, and will likewise save and hold the second party free and harmless from all costs, expenses and counsel [178] fees which it may be compelled to pay out in defending itself and its property from any such claim or claims; provided that nothing herein contained shall be deemed to relieve the second party from liability for damages or injuries caused by its neglect or misconduct, after notice from the first party.

[Second party may remove oil, etc.]

Subject to its royalty obligations, conditions, payments and deliveries to first party herein contained

and reserved to first party, and the limitations herein contained, the second party shall have the right to remove and take away from said premises such petroleum oil, natural gas and kindred mineral substances as it may find therein and thereon.

[Drilling obligations of second party.]

Second party covenants and agrees that within ninety (90) days from the date hereof it will actually commence the drilling of at least three wells for the production of oil or gas upon said premises, and that it will prosecute the drilling of said wells continuously and diligently to completion.

The second party shall at all times from and after eight months after the date of this instrument keep ten (10) strings of tools for the drilling of wells and production of oil or gas in continuous operation on the premises hereinabove described while the total gross production of petroleum oil from said premises is under ten thousand (10,000) barrels of oil per day. Thereafter the second party shall keep five (5) strings of such tools in continuous operation on said premises while the total gross production of petroleum oil from said premises is under twenty thousand (20,000) [179] barrels of oil per day. Thereafter and while the total gross production from said premises is twenty thousand (20,000) barrels of petroleum oil or more per day the second party shall not be obligated to operate any further strings of tools; but nothing herein contained shall be taken to prohibit the second party from drilling

as many wells and from operating as many strings of tools on the premises or the portions thereof which are subject to this instrument as it may desire.

[Offset wells.]

The second party agrees to promptly offset all paying or drilling wells drilled on adjacent land by it or by any other person, within five hundred (500) feet of the boundary lines of Parcels One (1) and Two (2) herein described, by drilling and thereafter operating in a thorough workmanlike and effective manner on said leased premises along said boundary lines any paying wells while said wells on such adjacent property are being operated or drilled. Offsetting wells shall be located within five hundred (500) feet of the boundary line, and so far as practicable, at least as near to said boundary line as such wells are drilled on the adjacent property and equal thereto in number. Strings of tools operated by the second party in drilling such offset wells shall be included in computing the total number of strings of tools which the second party is obligated to operate. It is understood and agreed that there are now being drilled by the first party upon said premises two wells. [Existing wells.] The strings of tools operated by the first party in the drilling of said wells shall be deemed a part of the strings of [180] tools which the second party is obligated hereunder to operate, so long as the second party continues the operation thereof. And

in computing the total gross production of oil from the premises the present or future production from wells heretofore drilled or now being drilled on the premises shall be included.

[Suspension of drilling.]

The drilling obligations of the second party hereunder shall be suspended while, but only so long as, the second party is prevented from complying therewith in part or in whole by strikes, lock-outs, acts of God, unavoidable accidents or other matters beyond the control of the second party.

[Cessation of drilling.]

If the second party so elects it may at any time and from time to time cease the operation of all or any part of the number of strings of tools, the operation of which is herein provided for. But unless the second party shall thereupon and within eight (8) months from date of notice from the first party so to do, resume the operation of the number of strings of [Surrender of land except ten acres for well.] tools herein specified, the second party shall surrender to the first party all the land hereinabove described free and clear from all claims under this instrument, except ten (10) acres of said premises, for each well drilled that produces oil in paying quantities or that the second party is pumping or for which the second party is diligently drilling; such acreage to be selected by the second party in such form as to best protect such wells in the judgment of the second party from drainage, but as near a rectangle form as is pos-

sible for each ten acres so selected allowing ten acres for [181] each of said wells, provided that on each ten acres so selected there shall be situated a well producing oil in paying quantities, or which the second party is pumping or for which it is drilling.

Such surrender shall be by appropriate instruments in writing, duly executed and acknowledged so as to entitle the same to be recorded and second party covenants and agrees that it will execute and deliver such instruments when thereunto demanded by the first party. In the event that the second party shall surrender this instrument as to all portions of the premises except ten acres for each well, as hereinbefore provided, the second party may continue to hold, operate and drill additional wells on the land so retained as long as oil or gas is produced in paying quantities therefrom or the drilling of additional wells is progressing diligently thereon, but not beyond the expiration of the term of this instrument or its earlier termination as herein provided.

[Gas computed as part of production.]

For the purpose of fixing the drilling obligations of the second party wells producing gas shall be included in computing the gross production from said premises. And for such purpose twelve thousand (12,000) cubic feet of gas sold off the premises shall be taken as the equivalent of one barrel of oil, but nothing herein contained shall obligate the second [Second party not obligated to save gas.] party

to prospect for, drill for, produce, develop, save, store, market, or transport gas or kindred mineral substances, or any of them other than petroleum oil, nor shall gas be deemed as part of the production un- [182] less the same is sold and delivered from off the said leased premises. At the option of the first party the second party shall store, from time to time, during the term of this instrument, free of charge, but at first party's risk, for thirty (30) days in tanks pro- [Storage or purchase of realty oil.] vided by the second party on said premises the royalty oil of the first party when and as the same is ascertained, or at the option of the first party the second party shall purchase said royalty oil from the first party and shall pay the first party therefor the highest price which the second party is then paying or is then obligated to pay at such time to others for oil of like grade and gravity produced in the same vicinity, or in the Whittier-Fullerton field. If there be no such price, then the price to be paid by the second party to the first party shall be fixed by mutual agreement, and if the parties cannot agree as to the price so to be paid, then the first party shall take its royalty oil in kind.

[Notice of option.]

From time to time, whenever the first party exercises its option with reference to the delivery of its royalty in kind, or the payment therefor by the second party, the first party shall give to the second

party thirty (30) days' notice of such exercise of option. [Storage of royalty oil.] The second party whenever it shall store the royalty oil of the first party shall separately store the royalty oil produced and saved from each of parcels One and Two hereinabove described, and shall not mingle the same, but the second party shall not be obligated to separately tank or store oil produced or saved from different wells on the same parcel. [183]

[Royalty after five years.]

After the period of five (5) years from the date hereof the second party shall deliver to the first party when and as produced as royalty on the part of the land where produced and saved a one-fourth (¼) part of all oil produced and saved on the premises, which one-fourth (¼) part of such oil is herein reserved to the first party. For the period of five (5) years from the date hereof the second party shall not be obligated to pay or deliver to the first party as royalty or otherwise any part of the oil up to seven hundred and thirty thousand (730,000) barrels of oil produced [Royalty during first five years.] and saved by the second party on the premises in each of said five (5) years, but the second party shall have and take the first seven hundred and thirty thousand (730,000) barrels of oil, or such part thereof as may be produced and saved in any one year during each of the first five years from the date hereof, free of royalty to the first party. If the production is in excess of seven

hundred and thirty thousand (730,000) barrels of oil in any one year during the first five (5) years of said time, then all oil produced from parcel number one up to 1000 barrels per day shall constitute a part of the oil to be taken by second party free of royalty. The royalty reserved by the first party and which the second party pursuant hereto shall be obliged to deliver to the first party during the period of five (5) years from date hereof, shall be only one-fourth (¼) of the oil produced and saved from said premises in excess of seven hundred and thirty thousand (730,000) barrels in any one of the said years, [184] but thereafter such royalty shall be one-fourth (¼) of all the oil produced and saved from the premises.

[Tank reservation.]

This instrument is subject to the reservation that the first party may, and first party hereby reserves the right to, erect at its own expense on each of the four parcels herein described a tank or tanks sufficient in number and capacity to receive, and for the purpose of receiving royalty oil, for the storage necessary for the sale and transportation thereof from such tank or tanks with rights of way across the premises for pipe lines, telephone and telegraph lines for the purpose of transporting such royalty oil. Provided, that such pipe lines, telephone and telegraph lines, tank or tanks, shall be constructed and maintained on each of said parcels in such manner as to interfere as little as possible with the

operations of the second party hereunder, and shall after notice to first party be moved at second party's expense if second party's operations so require. [First party may use facilities at Los Nietos.] The first party shall have the right to use free of charge tracks, make connections with, and use loading racks of second party at Los Nietos for loading and transportation of said royalty oil.

[Gas royalty.]

The second party shall pay to the first party two (2¢) cents for each one thousand (1000) cubic feet of gas measured on an eight (8) ounce base produced and sold off the premises by the second party, or used by the second party on other premises than those hereinabove described or in operations not pertaining to the drilling, developing or operation of the premises hereinabove described and not pertaining to the storage [185] or transportation of the products produced from the said premises, or in manufacturing or transforming said gas into some other product for either use or sale.

[Royalty payments.]

All payments of royalty from the second party to the first party shall be made by the second party on the fifteenth (15th) day of each and every month of said term of this instrument, or while this instrument remains in force, calculated on the production of the preceding calendar month.

[Monthly statements.]

The first party shall be furnished monthly by second party not later than the fifteenth day of each

and every month of said term with a true statement of all the oil produced and saved on the said leased premises during the previous calendar month.

[Logs.]

Second party covenants and agrees that it will, during the term of this instrument, and while it is in force, keep an accurate log or record of each well in accordance with its practice at the time, and will furnish copies of such log or record to the first party at the end of each calendar month.

[Accounts and records of second party's operations.]

Second party further covenants and agrees that it will at all times during the term of this instrument, and while it remains in force, keep such full, true and just books of accounts and records on said premises of its operations, conducted thereon and therein, as shall fully, truthfully and completely show from time to time and from day to day the total amount of petroleum oil produced and saved, and of gas sold and delivered off said premises, or manufactured on said premises into other products, and of other com- [186] mercially valuable substances sold by said second party from said land, and said first party and the duly accredited and authorized representative or representatives of first party for the purpose of verifying the amount of oil produced and saved from said premises and the amount of royalty due to first party, shall have at all reasonable times during reasonable business hours full, free and unimpeded access to all such books and accounts, papers, files, records, reports, and log book on the premises, and the right to

inspect and audit and examine the same and take copies of the same, and to examine and inspect the leased premises and all wells drilled, operated, or being drilled or operated. [Monthly statements.] And the second party shall and will, during the term of this instrument render monthly statements on or before the tenth (10th) day of each calendar month to the said first party, addressed to its office at East Whittier, California, or to such other address as it may hereafter appoint and direct in writing, showing the total amount of all oil produced and saved and of all gas or other kindred mineral substances produced and sold or delivered by the second party from said parcels one and two during the preceding calendar month. [First party's inspection of oil runs.] The first party shall also have the right to have a representative upon said land who shall be entitled to inspect the run of oil produced and saved therefrom, or amount of gas sold off the premises, and for the purpose of facilitating such inspection it is further covenanted and agreed that before any gas is exported from said land the same shall be run through a meter or meters which [187] [Gas meters.] shall be open to and subject to the test and examination of the duly accredited representative or representatives of first party; and before any oil shall be exported from said premises the same shall have been pumped into and run off from tanks whose strapping and gauging the first party or its duly accredited representative or representatives shall have the privilege of checking and verifying; with the right to first party of sampling said oil for purposes of analysis thereof.

[Second party to operate paying wells.]

The second party agrees to pump and operate in a thorough and workmanlike and customary manner all wells on said leased premises or that may be hereafter drilled thereon while the same are producing oil in paying quantities.

[Defining paying well.]

A well producing oil in paying quantities within the meaning of this present instrument shall be a well producing not less than twenty-five (25) barrels of oil a day after thirty (30) days' continuous pumping, unless second party elects to consider a less quantity a paying quantity.

[Second party to plug abandoned wells; shutting off water.]

The second party shall not abandon any well without effectually plugging the same so as to prevent the water from invading the oil measures below. During the drilling or operating of any well on said premises, the second party shall at all times and in a timely and workmanlike manner use every endeavor and the most and best approved methods to prevent and shut off any water that may have been or may be encountered in such wells from invading the oil measures below. [188]

FORFEITURE, SPECIFIC PERFORMANCE AND DAMAGES.

[90 days' notice before forfeiture declared.]

No forfeiture will ever be claimed by the first party of this instrument or of any part thereof

unless the first party shall first give to the second party ninety (90) days' notice in writing at the office of the second party in San Francisco, California, by registered mail, such ninety (90) days to commence to run with the receipt of such notice by the second party.

[Second party's right to specific performance and damages.]

Upon the failure of the second party to comply with any of the covenants, stipulations and agreements, conditions or terms herein set forth after ninety (90) days' notice in writing as aforesaid, the first party may, at its option, by appropriate action in a court of law or equity, or otherwise, enforce specific performance of such covenant, stipulation or agreement, condition or term, and recover damages occasioned by such failure of the second party to comply therewith; [Forfeiture for failure to drill or pay royalty] provided that if the second party after ninety (90) days' notice given as aforesaid, shall fail to pay and deliver to the first party any royalty or royalties or payments due hereunder, or if the second party, after such ninety (90) days' notice given as aforesaid, shall fail to proceed with its drilling obligations as herein provided, and such failure of the second party to pay or deliver such royalty or drill is not expressly provided for in this instrument, the first party may, at its further option, claim a forfeiture of this instrument, and of the rights of the second party therein and thereunder, and thereupon all of

the rights of the second party under this instrument shall immediately cease and determine, and said instrument shall be canceled, [189] and said leased property shall return to the first party, and said first party, its successors or assigns, shall have the right to immediately re-enter said premises and oust the second party and all persons therefrom and repossess the same as in its former estate; provided that no surrender, termination or forfeiture of this instrument in whole or in part, shall affect the rights of the second party as to any wells producing oil or gas or which the second party is pumping, or on which it is drilling, or in or to ten (10) acres for each of such wells selected as herein provided. [Second party to retain wells with ten acres for each well.] But the second party delivering and paying the royalty in the manner herein provided, shall continue in the possession of each well or wells which are producing or which it is pumping or on which it is drilling, together with each of said ten (10) acres for each of such wells, with all rights and privileges as to such acreage which are herein granted to the second party as to the premises herein leased, and subject to and upon all the terms and conditions of this instrument, together with all rights of ingress, egress and regress to and from the same, and all water rights, and including all rights of way for telephone and telegraph lines, and for pipe lines for the transportation of oil, gas and water on, in, under and across the four parcels herein described, or any of them, or between any

of said parcels, for the full term of forty (40) years from the date hereof as hereinabove provided.

No surrender, termination or forfeiture of this instrument, in whole or in part, shall affect the right or [190] [Rights of way and title to property not affected by forfeiture.] title of the second party in or to any rights of way, granted to the second party by separate instrument as herein referred to, or in or to the rights of way, water rights or other rights and privileges necessary and convenient to the possession of any acreage or wells retained by the first party as herein provided, or in or to any of the personal property, fixtures or other property, purchased by it as hereinabove provided, excepting only such property as is not removed by it from the premises before the expiration of ninety (90) days after the total cessation of second party's possession hereunder of said premises or of any part thereof whereon such property not so removed may be situate.

[Grounds of forfeiture.]

The first party shall not be entitled to a forfeiture or termination of this instrument for breach by the second party of any of the covenants, stipulations and agreements, conditions or terms herein set forth except the covenants and obligations of the second party to pay and deliver to the first party the royalties and payments herein provided, and to drill as herein provided, and then only after notice and continued failure of the second party as here-

inbefore specified. But as to the breach by the second party of any and all other covenants, stipulations, and agreements, conditions or terms herein contained, the first party shall have and be relegated to its remedy by specific performance and to its rights to damages.

[First party free gas.]

The first party shall be entitled to gas for domestic use in two buildings on the premises herein leased, and in three buildings off said premises, free of charge [191] but the use of such gas and transportation thereof shall be at the first party's own risk and cost.

Should first party desire to use any gas produced on Parcel One in its orchards adjacent thereto during the term of this instrument, it shall have the privilege of doing so free of all charges or deductions on the part of second party therefor.

[Removal of property by second party.]

Within ninety (90) days after the termination of this instrument, or after the surrender of any portion of the premises herein leased, or at any other time prior thereto, the second party may remove such property as it may place or install or may have placed or installed on said premises or on any portion thereof, or as may now be thereon, whether the same be fixtures or not, including all property and improvements purchased from the first party pursuant to the provisions hereof, excepting only pipe lines purchased from the first party and which

are in place at the time of such termination or surrender and not theretofore removed by the second party and excepting casing in [Casing in wells.] any well, if the first party elects to have such casing remain in such well and gives notice of such election in writing within ten (10) days after notice that such well is to be abandoned. Notice of the intention of the second party to abandon any well shall be in writing addressed to first party and either delivered or mailed by registered letter to its principal office at least thirty (30) days before such well shall be deemed to be abandoned.

The first party for the considerations hereinbefore recited does further lease to the second party for said [192] period of forty (40) years or so long as second party may be occupying the premises hereinabove described, or any part thereof, those certain premises situate in the County of Los Angeles, State of California, and more particularly described as follows, to wit:

PARCEL THREE.

[Parcel Three. Lease of Los Nietos property.]

Beginning at a point in the southerly line of the Colima Tract (so called) in the Rancho Santa Gertrudes, north fifty degrees (50°) thirty minutes (30′) west two hundred fifty-one and ninety-six hundredths (251.96) chains from the most southerly corner of said tract, and being the southeast corner of the sixty-seven and eighty hundredths (67.80) acre tract of land described in deed from

Eduardo Pollorino and wife to W. H. Hull and Alfred W. Allyn, dated February 15th, 1888, recorded February 16th, 1888, in Book 376, page 154 of Deeds, Records of Los Angeles County; thence along the southerly line of said Colima Tract north fifty degrees (50°) thirty minutes (30′) west six and seventy-five hundredths (6.75) chains, more or less, to its intersection with the northeasterly line of the right of way of the Southern California Railway; thence in a northwesterly direction along said last mentioned line seven and forty-one hundredths (7.41) chains, more or less, to its intersection with the southeasterly line of the right of way of the Southern Pacific Railroad (Whittier Branch); thence along said last mentioned line in a northeasterly direction fourteen and sixty-seven hundredths (14.67) chains, more or less, to its intersection with the easterly line of said sixty-seven and eighty hundredths (67.80) acre [193] tract; thence along said easterly line south thirteen degrees (13°) thirty minutes (30′) west three and ninety-five hundredths (3.95) chains, more or less, to the southwest corner of the tract of land now or formerly owned by D. C. Cartwright; thence south seventy-six degrees (76°) thirty minutes (30′) east forty-two (42) links; thence south thirteen degrees (13°) thirty minutes (30′) west twelve and eighty-seven hundredths (12.87) chains to the point of beginning; containing ten and two-tenths (10.2) acres, more or less.

PARCEL FOUR.

[Parcel Four. Lease of parcel in Whittier.]

Part of lot one (1) in block "M" of the Pickering Land and Water Company's Subdivision of the John M. Thomas Ranch, in the City of Whittier, as per map recorded in Book 21, pages 53 and 54, Miscellaneous Records of said county, described as follows, to wit:

Commencing at the northwest corner of said lot one (1); thence east along the south line of Short Street, 268.71 feet to a point; thence south 180.12 feet, more or less, to a point in the north side of the county road; thence in a northwesterly direction along the north side of said county road, 317.53 feet to the point of beginning.

[Further instruments by second party.]

The first party shall, whenever thereunto requested, execute and acknowledge so as to entitle the same to be recorded, such further instruments of assignment and transfer of the fixtures, rights of way and other personal property of the first party herein granted, bargained, sold, conveyed, transferred, assigned and [194] set over as the second party may, for purposes of record or otherwise, require. The rights of way hereinabove sold, transferred and assigned to the second party, except such rights of way as are granted to the second party by separate instrument as herein referred to, shall by it, by appropriate instrument in writing executed and acknowledged so as to entitle the same to be recorded, be reconveyed, retransferred and

reassigned whenever the second party shall no longer require the same in the use or enjoyment of the acreage and wells thereon, retained by the second party as herein provided in the use or enjoyment of any of the property herein conveyed, transferred, sold, assigned, set over or leased to the second party, or upon the expiration or other sooner termination of the term of this lease.

[Taxes, liens, assessments.]

The second party hereby covenants and agrees to hold the first party harmless against and the premises herein described free and clear of all taxes and assessments of every kind and nature levied and assessed during the life of this instrument upon any of the property of the second party situate on the premises herein leased and shall pay before the same are delinquent any and all such taxes and assessments; and shall hold the first party and the said premises free and clear of all costs, expenses and damages by reason of any liens placed upon said premises on account of the operations of the second party thereon, and shall at all times during the term of this instrument keep the said leased premises free and clear of all liens or claims for damages of every kind or character grow- [195] ing out of the possession or the operations of the second party on said premises.

The second party agrees to repay to the first party all such sums as the first party may be compelled to pay hereunder for the purpose of discharging such taxes and assessments or of removing such

lien or liens by reason of the failure of the second party so to do with interest at seven (7%) per cent. per annum from the date of such payment.

It is hereby further agreed and covenanted on the part of the second party that the first party shall at its option have the right at all times during said demised term, but only after ten days' notice to the second party given as herein provided, to pay any rates, taxes, assessments in this instrument provided to be paid by the second party and levied or assessed upon said premises and reversionary interests therein, remaining unpaid after the same have become due and payable, and after similar notice to second party to pay, cancel and clear off all tax sales, liens, demands and claims arising out of any charges on said property upon or against said demised premises or reversionary interest therein, which charges are herein provided to be borne and paid by the second party, and to redeem said premises from the same or any of them, from time to time, and the amount paid including reasonable expense shall be so much additional rent due from the second party at the next rent or royalty payment day after any such payment with interest thereon at the rate of seven (7%) per cent. per annum from the date of the payment thereof by the said first [196] party until the payment thereof to the said first party by the said second party.

And it is further provided that if the first party at its option and after ten days' notice to the second

party given as herein provided shall advance or pay any such rate, taxes or assessments, or other charges, or pay, cancel and clear off any tax sale or charges or claims arising out of any charges which the second party is obligated to pay under the terms of this instrument, and which are levied or assessed upon and against said demised premises, or the reversionary interest therein, it shall not be obligatory upon the first party to inquire into the validity of any such rate, tax, or assessment, or other charge, or any such tax sale or lien.

If the second party elects to contest the validity of any such rate, tax assessment, tax sale, charge, lien or claim, and indemnifies the first party against loss or damage which may ensue if the same should prove to be valid, the first party shall not after notice from the second party of its election to contest the same, pay, cancel, or clear the same except at its own expense.

[Taxes on premises.]

The first party agrees to pay all taxes assessed, during the term of this instrument, against the premises herein described and on its property situate on said premises; provided that the second party shall pay three-fourths of the increase in taxes arising out of the increase in the valuation of said premises due to the operations of the second party, and the first party agrees to pay one-fourth of such increase in said [197] [Increase due to operations of parties; how paid.] taxes, and an increase of taxes for any year on any ten acres of land on

which the second party drills or has drilled in such year shall be conclusively presumed to have been caused by the operations of the second party and an increase of taxes for any year on any ten acres of land on which the first party has used the surface rights as herein reserved, in such year and on which the second party has not drilled or is not drilling, shall be conclusively presumed to have been caused by the operations of the first party.

[First party not liable for damages from second party's operations.]

The second party covenants and agrees to hold the first party harmless from any and all claims and demands of any nature whatsoever which may be made against the first party for damages or injuries suffered or claimed to have been suffered by any person whether the same be personal injuries or injuries or damage to property by reason of or arising out of second party's operations on said premises, or any of them, and will likewise save and hold the said first party free and harmless of and from all costs, expenses or counsel fees which it may be compelled to pay out in defending itself and its property from any such claim or claims.

[Defining "barrel".]

The term "barrel" where used in this instrument shall be deemed to be a barrel of forty-two (42) United States wine gallons in bulk.

[Second party's rights not assignable; exceptions.]

It is further covenanted and agreed by and between the parties hereto that the said second party

shall not transfer or assign this instrument, nor assign nor sub-contract any of the rights herein granted, to prospect for, drill for, produce or develop oil, gas or kindred [198] mineral substances, nor underlet nor sublet the said premises or any part thereof, without the consent in writing of the said first party being first had and obtained, and if at any time during the term of this instrument, in any judicial proceeding or action in any court against the second party, its successors or assigns, or by reason of the bankruptcy of said second party, or its dissolution, or the forfeiture of its corporate rights, a receiver or other officer or other agent shall be appointed to take charge of said premises or business thereon conducted by said second party, its successors or assigns, and shall remain in possession thereof for a period of more than sixty (60) days after final order or final decree in judicial proceedings, whereby said receiver, officer or agent is appointed, or a judicial sale of said leasehold interests pursuant whereto the title to said leasehold interest shall be finally transferred, be had without the written consent of said first party being first had and obtained, then and in that or either of said events the said first party may at its option after ninety days' notice given to the second party as herein provided, terminate this instrument and re-enter said premises and remove all persons therefrom.

Provided that nothing herein contained shall be deemed to prohibit the second party from trans-

ferring or assigning this instrument and all or any part of the right, title and interest of the second party therein and thereunder, to any person or persons, trust estate or trust estates, corporation or corporations, association or associations, of persons which may, by transfer [199] or by operation of law or otherwise, become the successor or successors of the business of the second party in the producing and/or transportation of oil or gas.

[Payments to first party discharge second party's liability.]

The second party shall not be bound by, or be bound to recognize, any pledge, assignment, transfer, sale (judicial or otherwise), or other disposition of the first party's rights to the payments and royalties in this instrument provided to be paid and delivered, but may at all times make such payments, and pay or deliver such royalties to the first party or to the written order of the first party, and be thereby fully discharged of its obligations under this instrument in that behalf.

[Payments to be made without default; exception.]

The said second party covenants and agrees that it will well and truly and faithfully keep and perform each and every of the conditions, covenants, stipulations and agreements herein provided to be kept and performed by said second party, and that it will well and truly and without delay or deduction, except deductions for income taxes or other deductions required by law, make all payments in this instrument provided upon its part to be paid,

[Time of essence.] and it is hereby expressly declared and understood and agreed by and between the parties hereto that time is of the essence of this instrument and of every covenant, promise, stipulation, condition and agreement therein contained obligatory upon the said second party and therein provided to be kept and performed by said second party, or obligatory upon said first party and provided to be kept and performed by said first party. [200]

[Obligations, rights and options cumulative.]

It is further mutually covenanted and agreed by and between the parties hereto that the various rights, powers, options, elections, appointments and remedies of the first party or of the second party contained in this instrument shall be construed as cumulative and no one of them as exclusive of the other or exclusive of any right or privilege allowed by law.

The termination of this instrument for any cause whatsoever, shall not affect the right of the first party to enforce any payment or obligation then due from the second party and unperformed by it.

[Notices; how served.]

It is further agreed as a condition of this instrument that in every case where in the opinion of the first party or under the conditions of this instrument it shall be deemed necessary for the interest of the first party to serve a notice or demand on the second party concerning this instrument or any of the condition or provisions thereof, it shall

be sufficient service of such notice to send the same by registered mail addressed as herein provided.

[Effect of waivers.]

It is further covenanted and agreed by and between the parties hereto that no waiver of the breach of any of the covenants, stipulations, conditions and agreements of this instrument by the first party shall be construed to be a waiver of any succeeding breach of the same covenants, conditions, stipulations or agreements after ninety (90) days' notice given as aforesaid that it is not to be so construed.

Said second party covenants and agrees that upon the termination of said demised term, the second [201] [Surrender on termination.] party will, except as herein otherwise expressly provided, immediately surrender or deliver up said above described premises peaceably to said first party, its agents or attorneys whether said termination is occasioned by abandonment, by forfeiture, or limitation. If the said second party, its agents, attorneys and tenants shall hold the said premises, or any part thereof one (1) day after the same should be surrendered according to the terms of this instrument, it or they shall be deemed guilty of unlawful detainer of said premises under the statute and shall be subject to eviction and removal forcibly or otherwise with or without process of law. [Holding over.] And it is further agreed that if the said second party shall hold over the said term of this

instrument with the consent, express or implied, of the first party, such holding shall be construed to be a tenancy only from month to month, and the said second party will pay the rentals and royalties herein provided for such further time as it may hold the same.

[Not a mining partnership.]

This instrument is not a mining partnership.

[Covenant for peaceable possession.]

The first party covenants and agrees to maintain and defend the possession and peaceable enjoyment by the second party of all the premises herein leased and of every part thereof for the full term of this instrument, or while it remains in force, while and so long as the second party observes and performs all of the terms, covenants and conditions of this instrument on its part to be kept and performed. [202]

RIGHTS OF WAY.

[Permanent rights of way to second party.]

The first party, in part consideration of the payments and other considerations hereinbefore referred to, will execute to the second party an instrument granting to it permanent rights of way, from time to time to construct, maintain, operate, remove or enlarge pipe lines, telegraph and telephone lines, across lands to the first party, the form of which instrument has been agreed upon between the parties hereto, and will be executed contemporaneously with the execution hereof.

TITLE.

[Examination of title; provisions as to defects, if any.]

The second party shall have ninety (90) days from the date hereof within which to examine the title of the first party to the premises herein described, and if in the course of such examination any defect in said title which would render the same unmarketable should be discovered, such defect shall within said period of ninety (90) days be called to the attention of the first party and said first party shall have six (6) months from the date thereof within which to cure such defect by proper legal or other proceedings. If the first party fails so to remove such defect, the second party shall have three (3) months thereafter in which to remove the same, and may do so at first party's expense, not exceeding one thousand dollars ($1,000). Unless within ninety (90) days from the date hereof the second party shall in writing report such defect, or if such defect, if any, be remedied within six (6) months by the first party, or within three (3) months thereafter by the second party, this [203] instrument shall remain in full force and effect; otherwise this instrument shall forthwith terminate and the second party shall vacate the premises and remove all material which it may have placed thereon and return and restore to first party all property received from first party and all oil taken from the premises or the value thereof, and the first party shall return to the second party

the considerations paid and delivered by the second party to the first party. If a defect in the title be discovered as hereinabove referred to, the second party's obligations to make the payments herein provided for, and to drill as herein provided, as well as the running of the time within which the second party shall drill, shall be suspended until said defect is removed or this instrument cancelled.

PREVIOUS CONTRACTS.

[Previous contracts.]

The contracts heretofore entered into between the parties hereto of and concerning the purchase of oil by the second party from the first party are hereby terminated and declared to be of no further force and effect from and after the date hereof.

GENERALLY.

[General.]

It is mutually covenanted and agreed by and between the parties hereto that this instrument and the provisions, rights and obligations thereof shall extend to and bind and inure to the benefit of (as the case may require) not only the parties hereto but each and every of their successors and assigns, and wherever in this instrument a reference to either of the [204] parties hereto is made such reference shall be deemed to include, wherever applicable, and refer to, the successors and assigns of such party the same as if in every case expressed. This instrument shall be executed in duplicate and the said first party shall have and hold one executed

copy, and the said second party shall have and hold the other executed copy.

IN WITNESS WHEREOF, the said parties hereto have by resolution of their respective Boards of Directors duly adopted and thereunto authorizing caused their respective corporate names to be hereunto signed and their respective corporate seals to be hereunto affixed by their duly authorized officers whose names are respectively hereunto undersigned.

MURPHY OIL COMPANY,
By WILLIAM H. MURPHY,
Its President.
(Seal) And by J. T. F. BAEYERTZ,
Its Secretary.
STANDARD OIL COMPANY,
By D. G. SCOFIELD,
Its President.
(Seal) And by F. H. HILLMAN,
Its Secretary.

Approved as to form,
OSCAR SUTRO,
BRADNER W. LEE. [205]

State of California,
City and County of San Francisco.—ss.

On this first day of December, in the year nineteen hundred and thirteen, before me, Frank L. Owen, a notary public in and for the said City and County of San Francisco, personally appeared William H. Murphy, known to me to be the president, and J. T. F. Baeyèrtz, known to me to be the sec-

retary of Murphy Oil Company, the corporation described in and that executed the within instrument, and also known to me to be the persons who executed it on behalf of the corporation therein named, and they acknowledged to me that such corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

(Seal) FRANK L. OWEN,
Notary Public in and for the City and County of San Francisco, State of California.

State of California,
City and County of San Francisco.—ss.

On this first day of December, in the year nineteen hundred and thirteen, before me, Frank L. Owen, a notary public in and for the said City and County of San Francisco, personally appeared D. G. Scofield, known to me to be the president, and F. H. Hillman, known to me to be the secretary of Standard Oil Company, the corporation described in and that execu- [206] ted the within instrument, and also known to me to be the persons who executed it on behalf of the corporation therein named, and they acknowledged to me that such corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

(Seal) FRANK L. OWEN,
Notary Public in and for the City and County of San Francisco, State of California.

State of California,
City and County of San Francisco.—ss.

William H. Murphy, being first duly sworn, deposes and says: That he resides in the City of Detroit, State of Michigan; that he is the president of the Murphy Oil Company, the corporation described in and which executed the above instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporation's seal; that it was so affixed by order of the board of directors of said corporation, and that he signed his name thereto by like order.

WILLIAM H. MURPHY.

Subscribed and sworn to before me this first day of December, 1913.

(Seal) FRANK L. OWEN,
Notary Public in and for the City and County of San Francisco, State of California. [207]

State of California,
City and County of San Francisco.—ss.

D. G. Scofield, being first duly sworn, deposes and says: That he resides in the City of Alameda, State of California; that he is the president of the Standard Oil Company, the corporation described in and which executed the above instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporation's seal; that it was so affixed by order of the board of directors of

said corporation, and that he signed his name thereto by like order.

D. G. SCOFIELD.

Subscribed and sworn to before me this first day of December, 1913.

(Seal) FRANK L. OWEN,

Notary Public in and for the City and County of San Francisco, State of California.

THIS IS TO CERTIFY that we and each of us are stockholders of Murphy Oil Company, a corporation, owning and holding of record the number of shares of the capital stock of said Murphy Oil Company, which said number is set opposite our respective names, to wit:

Names.	Shares.
William H. Murphy, Trustee	16662
William H. Murphy	3334
Bradner W. Lee	1
J. T. F. Baeyertz	1
T. G. Sutherland	1
A. Schinneller	1

[208]

That the instrument of conveyance, transfer and sale and of lease executed by Murphy Oil Company and the Standard Oil Company, corporations respectively, to which this certificate is attached, is by each of us for himself, and not for another, hereby ratified, approved and confirmed, and each of us

does hereby for himself and not for another hereby consent to the same.

Dated, December 1, 1913.

WILLIAM H. MURPHY, Trustee,
WILLIAM H. MURPHY,
BRADNER W. LEE,
J. T. F. BAEYERTZ,
T. G. SUTHERLAND,
A. SCHINNELLER,

State of California,
City and County of San Francisco.—ss.

On this 1st day of December, 1913, before me, Frank L. Owen, a notary public in and for the City and County of San Francisco, State of California, residing therein, duly commissioned and sworn, personally appeared William H. Murphy, Bradner W. Lee and J. T. F. Baeyertz, known to me to be the persons whose names are subscribed to the within consent, and they severally acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at the City and County of [209] San Francisco, State of California, on the day and year first above written.

(Seal) FRANK L. OWEN,
Notary Public in and for the City and County of San Francisco, State of California.

State of California,
County of Los Angeles.—ss.

On this 24th day of December, in the year nineteen hundred and thirteen, A. D., before me, Louis P. Tappeiner, a Notary Public in and for the said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared T. G. Sutherland and A. Schinneller, also known as Albert Schinneller, personally known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal in said county the day and year in this certificate first above written.

(Seal) LOUIS P. TAPPEINER,
Notary Public in and for Los Angeles
County, State of California. [210]

State of California,
City and County of San Francisco.—ss.

On this 1st day of December, 1913, before me, Frank L. Owen, a notary public in and for the City and County of San Francisco, State of California, residing therein, duly commissioned and sworn, personally appeared William H. Murphy, trustee, known to me to be the person whose name

is subscribed to the within consent as trustee, and acknowledged to me that he executed the same as such trustee.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at the City and County of San Francisco, State of California, on the day and year first above written.

(Seal) FRANK L. OWEN,

Notary Public in and for the City and County of San Francisco, State of California.

State of California,

City and County of San Francisco.—ss.

THIS IS TO CERTIFY that the Murphy Oil Company, a corporation organized and existing under the laws of the State of California, has an authorized capital of two million dollars ($2,000,000.00), and the number [211] of shares into which it is divided is twenty thousand shares of the par value of one hundred dollars ($100.00) each; that the total amount of the issued capital stock of said corporation and the number of its shares which have been issued and are now outstanding is twenty thousand shares, and that the following named persons are the holders of record upon the books of said company of the number of shares

of its issued capital stock set opposite their respective names, to wit:

Names.	Shares.
William H. Murphy, Trustee	16,662 shares
William H. Murphy	3,334 "
Bradner W. Lee	1 share
J. T. F. Baeyertz	1 "
T. G. Sutherland	1 "
A. Schinneller	1 "
	20,000 shares

(Seal) J. T. F. BAEYERTZ,
Secretary of Murphy Oil Company,
a corporation.

Dated, December 1, 1913. [212]

MURPHY OIL CO.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 14440. Promulgated March 30, 1929.

1. Legal expenses and a payment in compromise of a suit alleging petitioner acquired oil properties by fraudulent means and seeking to recover the properties, together with an accounting for profits obtained from dealings with such properties, were

not personal expenses, nor were they deductible as business expenses, for that portion allocable to the defense of the claim against title was a capital expenditure.

2. The claim for an accounting was a distinct claim involving a distinct group of assets and that portion of the expenses and compromise payment allocable to the defense and settlement of such claim, if a capital expenditure, has nothing to do with the oil properties and should not be added to the depletable capital account thereof, and, in the absence of evidence permitting a proper allocation of the expenses and payment between the two claims, no allowance may be made as a business expense or as additional depletion. [213]

3. A cash bonus payment by the lessee for an oil and gas lease represents taxable income and, having no relation to exhaustion of resources, does not reduce the depletable base of the lessor.

4. The depletable base determining the depletion allowance under the 1918 Act is reduced by the exhaustion actually sustained in prior years and not by the amount of the deductions allowable for prior years under prior Revenue Acts. Thompson Oil & Gas Co., 15 B. T. A. 993, followed.

Randolph E. Paul, Esq., Valentine B. Havens, Esq., Charles B. McInnis, Esq., Thomas R. Dempsey, Esq., and A. Calder Mackay, Esq., for the petitioner.

John D. Foley, Esq., and Lloyd W. Creason, Esq., for the respondent.

This proceeding results from a determination of deficiencies in income and excess-profits taxes for the

calendar years 1919 and 1920 in the amounts of $76,740.20 and $321,660.33, respectively, all of which are in controversy. The errors assigned are as follows:

(1) The respondent erred in refusing to allow, as a deduction from gross income for the year 1919, the sum of $1,200,000 paid in that year in settlement of a suit for an accounting brought against the petitioner relative to its Coyote Oil Properties.

(2) The respondent erred in refusing to allow as a loss deduction for the year 1919 the sum of $170,877.24 paid in that year as legal expenses in defending an action against the petitioner for an accounting relative to a portion of its oil properties, to wit, its Coyote Oil Properties.

(3) The respondent further erred in determining that the legal expenses incurred in 1918 and 1919 and the amount of the compromise payments in 1919 in connection with such suit constitute capital expenditures, and at the same time failing to determine that such amounts should be amortized over the remaining life of the said oil properties.

(4) The respondent erred in deducting from the capital sum returnable through depletion of the petitioner's Coyote Oil Property, an amount of $4,517,402.70, representing a bonus received by the petitioner upon the leasing of the said oil property, in computing the amount of depletion sustained by the petitioner in connection with the said Coyote Oil Property for the calendar years 1919 and 1920.

(5) The Commissioner erred in reducing petitioner's depletable base for both the Whittier and

Coyote oil properties by an amount alleged to represent depletion sustained on the March 1, 1913, value and subsequent cost of the said properties during the period from March 1, 1913, to December 31, 1915, whereas he should have reduced petitioner's depletable base by the amount of depletion which [214] petitioner was legally entitled to take as a deduction in determining its taxable income for the said period from March 1, 1913, to December 31, 1915.

FINDINGS OF FACT.

Petitioner corporation was organized on or about August 18, 1904, under the laws of California and has its home office at Whittier, Calif. It took over from Simon J. Murphy certain oil properties among which was an oil and gas lease on certain land situated in California and owned by Domingo Bastanchury. The petitioner, through Edmund W. Bacon, one of its officers and its agent, purchased 2,240 acres of land (hereinafter referred to as the Coyote properties) covered by such lease for $35 per acre, or $78,400, the deed to Murphy being dated December 15, 1904, and the deed from Murphy to petitioner being dated January 9, 1905. The purchase agreement involved also a cancellation of the oil and gas lease and the leasing of the surface rights to Bastanchury for 10 years for grazing purposes.

At the time Bacon purchased property a well (hereinafter referred to as well No. 1) had been drilled to considerable depth under the lease, drilling operations had ceased, and the well had been

capped. Drilling operations were resumed after the land was acquired by petitioner.

On August 26, 1918, after petitioner had leased the Coyote properties to the Standard Oil Co. as set out below, Maria Bastanchury, as administratrix of Domingo Bastanchury, filed a complaint in the Superior Court of Los Angeles County against petitioner and Bacon. The complaint alleged that petitioner and Bacon had fraudulently misrepresented to the Bastanchurys that well No. 1 was a dry hole, that indications of the presence of oil were destroyed or covered up to prevent the Bastanchurys from learning of their existence, and, that petitioner was about to abandon the lease. It was further alleged that no grounds for suspecting fraudulent misrepresentations had been discovered by the Bastanchurys until shortly before the filing of the complaint; that the misrepresentations had been made to induce complainants to sell the property for far less than its real worth; and that the Bastanchurys relied upon the misrepresentations in canceling the lease and selling the land.

The bill prayed that the defendants be required to account to plaintiff for all moneys or other things of value (in excess of $78,400, the price paid) obtained by them from their dealings with the Coyote properties, or from their dealings with the proceeds from the sale or operation thereof. It was also prayed that the defendants be required to assign and transfer to plaintiff all rights to receive such moneys and things of value in the future; that a receiver be appointed [215] to collect and receive from

the then lessee, the Standard Oil Co., for the benefit of the plaintiff that which such lessee has become obligated to pay defendants as respects such properties; and such other and further relief as the court may deem meet and agreeable to equity, the premises considered, and for costs.

The answer filed late in 1918 denied all of the allegations set forth in the bill. The answer alleged that plaintiff, or her deceased husband, his heirs, devisees and personal representatives, had knowledge or notice by 1906 of all of the facts alleged to indicate fraud, that defendant Bacon had received any portions of the moneys or things of value derived from dealing with the land; that the land when purchased had a value in excess of $87,400. Other defenses set up in the answer include the statute of limitations (sec. 318, 319, 338, 343 and 353, Code of Civil Procedure of the State of California); laches; adverse possession and user since January of 1905; drilling and development of the property (with the knowledge and acquiescence of the Bastanchurys) by petitioner at heavy expense until the property was leased in 1913 which greatly enhanced the value thereof; transfers of stock of petitioners to purchasers for value without notice of the alleged fraud, etc.; and alleged the relief prayed for would be inequitable and that plaintiff's remedy, if any, was for damages.

Legal expenses incurred during the year 1918 amounted to $32,151.77. During the year 1919, further legal expenses totaled $170,877.24. During the latter year judgment in the amount of $1,200,000, as

damages for the alleged wrongful acts was entered against, and paid by, petitioner in such suit pursuant to an agreement between the parties in compromise settlement. Petitioner, after investigation, had concluded that the action had no merit, but agreed to pay the amount agreed upon in compromise rather than continue the litigation, as the anticipated cost thereof would have equaled the amount of the settlement. Petitioner also deemed it advisable to avoid the disagreeable notoriety accompanying the suit. An instrument was executed by the Bastanchurys, including all the heirs and legatees, releasing petitioner, and all other persons or corporations claiming to own any interest in the land conveyed by the deed of December 15, 1904, from any further causes or actions for damages or rights on account of the alleged fraudulent acts.

The legal expenses incurred in 1918 were deducted as an expense in that year. Those incurred in 1919, together with the $1,200,000 paid in final settlement, were deducted as expenses of that year. The deductions claimed were disallowed.

The respondent failed or refused to treat such legal expenses and the amount paid in compromise settlement as capital amortizable over the remaining life of the oil properties. [216]

By an instrument dated December 1, 1913, petitioner leased certain oil properties, known as the Whittier and Coyote oil properties, to the Standard Oil Co. of California for 40 years, and by the same instrument, sold to that company specified personal property, including fixtures, appurtenances,

tools, machinery and equipment, which were at that time located on or used in connection with such oil properties. The instrument recited cash consideration of $10 (and other consideration, the receipt of which was acknowledged, which a stipulation shows to have totaled $1,500,000) and additional payments to be made from time to time. The due date, the actual date of payment, and the amount of such additional payments may be tabulated as follows:

Due date	Date paid	Amount
Apr. 30, 1914	Apr. 1, 1914	$1,000,000
Mar. 31, 1915	Mar. 1, 1915	250,000
June 30, 1915	June 1, 1915	250,000
Sept. 30, 1915	Sept. 1, 1915	250,000
Dec. 31, 1915	Dec. 31, 1915	250,000
June 30, 1916	July 13, 1916	500,000
Dec. 31, 1916	Dec. 1, 1916	500,000
Dec. 31, 1917	Dec. 1, 1917	500,000
Dec. 31, 1918	Dec. 1, 1918	500,000
Total		4,000,000

The $1,500,000 paid down brings the total of such payments to $5,500,000. Petitioner also was to receive for the first five years a royalty of one-fourth of all oil produced in each year in excess of 730,000 barrels, and after the five-year period the royalty reserved amounted to one-fourth of the oil produced. The gas royalty agreed upon was a payment of 2 cents for each 1,000 cubic feet of gas saved and sold.

Of the $5,500,000 payments, the respondent determined that $326,404.82 represented payment for the personal properties sold and the remainder of $5,173,595.18 represented a bonus payment on the two properties. The respondent allocated such total bonus payment, $656,192.48 to the Whittier property and $4,517,402.70 to the Coyote property, and deducted the amount of such bonuses from the capital sums returnable through depletion in determining the unit of depletion sustained in 1919 and 1920, the years in controversy. Depletion deductions were based on March 1, 1913, value.

The gross production of the two properties in barrels of oil and the value thereof at the mouth of the wells from March 1, 1913, through the year 1915, is as follows:

	Coyote		Whittier	
During period	Barrels	Amount	Barrels	Amount
Mar. 1, 1913, to Nov. 30, 1913	344,094.63	$292,480.44	221,178.85	$133,968.52
Dec. 1, 1913, to Dec. 31, 1913	6,697.47	5,744.52	.....	.....
Calendar year 1914	151,424.90	127,000.42	5.50	3.30
Calendar year 1915	322,064.60	278,124.21	16,943.54	10,166.13
Total	824,281.60	703,349.59	238,127.89	144,137.95

[217]

The depletion determined by the respondent to have been sustained by the petitioner from March 1, 1913, through the year 1915 is as follows:

	Period, Mar. 1, 1913, to Dec. 31, 1913	1914	1915	Total
Whittier	74,048.17	$17,738.65	$38,021.95	$129,808.75
Coyote	183,327.41	135,572.08	306,749.76	625,649.25
Total	257,375.58	153,310.73	344,771.69	755,458.00

The respondent reduced petitioner's depletable base by the above amount of $755,458 in determining the depletion allowable for the years 1919 and 1920.

The respondent determined that the amount of oil produced from petitioner's share of the Coyote Oil property during the years 1919 and 1920 was 1,644,897 barrels and 1,340,237 barrels, respectively.

The respondent determined the oil reserves in the Coyote property at December 31 of 1918 and 1919 amounted to $5,051,424 and 3,406,527 barrels, respectively.

OPINION.

SIEFKIN: The issues raised in the first three allegations question the respondent's determination that the cost of the litigation in question and the payment made in compromise are neither deductible expenses nor capital cost which may be amortized over the remaining life of the properties. Apparently such determination was based on the conclusion that such expenditures represented personal expenses.

We think such conclusion unsound. The act complained of was committed, if at all, in the course of a business transaction. *Kornhauser v. United States,* 276 U. S. 145, citing with approval an administrative ruling of the Bureau where expenses of a suit for malpractice were allowed as a business expense deduction by a physician. In this case the suit brought was in no sense a prosecution for a crime or an attempt to impose a penalty. The

only remedy sought was a restitution of the property, together with income derived therefrom in the *interim*. See *Consolidated Mutual Oil Co.*, 2 B. T. A. 1067; and *Frederick McLean Bugher*, 9 B. T. A. 1155.

We can not agree, however, with petitioner's contention that the expenses and payment under discussion were deductible as business expenses or losses. The complaint filed in the suit alleged fraud and the relief prayed for was an accounting and that petitioner be required to assign and transfer to complainant all rights to receive moneys and things of value derived from the property in the future. [218] That is, the prayer asks for restoration of the property and all past income therefrom in excess of the consideration paid.

It should be noted at this point that the action was brought to recover two distinct classes of assets. One such class of assets was the oil properties as they existed at the time the suit was instituted. Petitioner recognized that the complaint questioned its title to the property and in answer to the prayer for restoration asserted such relief to be inequitable, and that complainant's remedy, if any, was for damages. The other asset (the accumulated earnings resulting from petitioner's operation or production in years prior to the beginning of the suit) was no longer a part of such oil properties as they had been severed from the realty. They formed a distinct group of assets to which claim was made in the action. It should, therefore, be borne in

mind that, though both claims grew out of the alleged fraud, there were, nevertheless, two distinct claims asserted against two different groups of assets.

To the extent that the expenses and payment were incurred and made in defense of the claim against the oil properties they were capital expenditures. We have repeatedly held that the cost of defending title, whether in the form of legal fees or compromise payments, is a capital expenditure representing additional cost of the property. *Lincoln L. McCandless,* 5 B. T. A. 1114; *Gopher Granite Co.,* 5 B. T. A. 1216; *Seletha O. Thompson,* 9 B. T. A. 1342; *Frederick McLean Bugher, supra; North American Oil Consolidated,* 12 B. T. A. 68; *Phoenix Development Co.,* 13 B. T. A. 414. The decisions in *Kornhauser v. United States, supra,* and *the Superheater Co.,* 12 B. T. A. 5, which are relied upon by the petitioner, are not in conflict with these cases. In the *Superheater* case the contemplated litigation grew out of an action of the board of directors, acting as such. The claim settled did not involve title. In the *Kornhauser* case the legal expenses were incurred to contest a claim against income received, differing fundamentally from the ordinary attack on title, even though the income in question consisted of shares of stock.

In view of such conclusion we must reject petitioner's contention that the total deductions claimed should be allowed. We can not allow the total and it would be idle for us to further consider whether

any part of such total (i. e., that portion allocable to the defense and settlement of the claim for accounting) is allowable as the record furnishes no basis for the apportionment of the whole among the several claims defended or settled.

The petitioner's contention that if the litigation and settlement costs are not deductible they must represent capital expenditures to be added to the amortizable capital value, must likewise be rejected. That portion of such costs which is properly allocable to the defense [219] and settlement of the accounting claim has nothing to do with title to the property or its future depletion. Assuming that such costs were capital expenditures, they relate to a claim against assets or moneys severed from the oil properties. *Frederick McLean Bugher, supra.* Undoubtedly that portion of such costs which we have held allocable to defense and settlement of the claim against the properties should increase the amortizable capital value, but we are again confronted with the fact that there is nothing in the record to permit a proper allocation to determine that amount. Accordingly, we must affirm the respondent's action on the points covered by the first three allegations of error.

The next error assigned is the reduction of depletable capital by the amount of the bonus received by the lessor as part consideration upon leasing the properties to the Standard Oil Co. of California in December of 1913. The respondent determined that $5,173,595.18 of the $5,500,000 payments received

represented such a bonus, and petitioner finds no fault with such allocation. Petitioner complains only of the admitted reduction of the capital base for depletion purposes on account thereof.

The respondent's present contention as set forth in his brief is as follows:

The Commissioner made an error of method in requiring the bonus of $656,192.48 on the Whittier property and the bonus of $4,517,595.18 on the Coyote property to be deducted as of December 1, 1913, from the capital sum returnable through depletion. On November 13, 1926, T. D. 3938 C. B. V.-2, p. 117, was promulgated amending Article 215 of Regulations 45 (1920 Edition) to read as follows:

"*Depletion—Adjustments of accounts based on bonus or advanced royalty.*—(*a*) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

While the Commissioner made an error of method in deducting from the depletion basis the *whole amount* of the bonuses as of December 1, 1913, it does not follow that the Commissioner's computa-

tion of the depletion basis is incorrect. There is nothing in the record of this case to show what royalties were on December 1, 1913, expected to be received over the lives of the leases. It is entirely possible that in the interval between December 1, 1913, and December 31, 1918, royalties expected on December 1, 1913, to be received. As to this point the taxpayer must fail for lack of proof.

The respondent confesses error to the extent that he failed to follow the regulation. It remains for us to test the validity of the rule therein promulgated. In *Nelson Land & Oil Co.,* 3 B. T. A. 315, we made it clear that, in our opinion, such a bonus received by a [220] lessor was not a return of capital but is an advance rental or royalty and is taxable as income. That case was followed in *R. H. Hazlett,* 10 B. T. A. 332, and we are not cited and have been unable to find any authority to the contrary. See also *Henry L. Berg,* 6 B. T. A. 1287; *John T. Burkett,* 7 B. T. A. 560; *D. R. McDonald,* 7 B. T. A. 1078; and *R. H. Hazlett, supra,* in which we held that such bonuses were not gains derived from the sale of "capital assets" under the capital gain provisions of the 1921 Act.

The bonus payment in the instant case was a part of the consideration paid for the lease. While expected production undoubtedly was considered in fixing the amount of the bonus, it is elementary under the laws governing such agreements that its payment did not, in any wise, depend upon, or relate to, production. The lessee's liability therefor

was fixed by the terms of the contract. On the other hand, the operation of the principle of depletion depends upon exhaustion of resources through production—i. e., the recovery of capital through its conversion from the form of oil resources or reserves into marketable products or the equivalent received for such product. Under such principle the depletion allowance for the year or years of the bonus payments can only be measured by reference to the oil produced. If, as we have pointed out, the bonus is income, no part of which represents recovery of capital, it follows that any depletion allowance against such income is a departure from the depletion concept. The regulation relied on by the respondent is clearly such a departure. While it might, in some cases at least, produce a more equitable result, the statutory allowance may not be so varied by administrative regulation.

It will be noted that the facts referred to by respondent in the last paragraph of the excerpt from his brief are essential only to the application of the rule laid down in the regulation. On the other hand, the respondent admits that he reduced the depletable base by the amount of the bonus (a known quantity) and we have held as a matter of law that no part of such bonus reduces such base. We can, on the facts presented, determine such action was erroneous. To correct such error we need only require the restoration of the amount subtracted, and it is so ordered.

The question raised by the last allegation was considered in *Thompson Oil & Gas Co.*, 15 B. T. A. 993, and decided adversely to the contention made by the petitioner herein.

Review by the Board.

Judgment will be entered under Rule 50.

MILLIKEN did not participate.

LANSDON, PHILLIPS, GREEN, and MURDOCK dissent. [220a]

[Endorsed]: Filed Dec. 7, 1929.

(Title of Court and Cause.)

PETITIONER'S NOTICE OF SETTLEMENT UNDER RULE 50.

The attached proposed settlement of the deficiency in the above entitled appeal will be presented to the Board on.....at 9:30 a. m., or as soon thereafter as counsel can be heard.

This notice of redetermination is submitted in accordance with the decision of the Board without prejudice to the petitioner's right to contest the correctness of the decision pursuant to the statute in such cases made and provided.

CHAS. B. McINNIS,
Attorney for the Petitioner,
Woodward Building,
Washington, D. C. [221]

(Title of Court and Cause.)

PETITIONER'S REDETERMINATION UNDER RULE 50.

1918.

This redetermination for the year 1918 is submitted solely for the purpose of showing that under the Board's decision, the petitioner had no net income for the year 1918 against which the 1919 net loss could be offset.

Net income finally determined by the Commissioner as set forth in his Certificate of Overassessment for the year 1918		$368,883.32
Depletion adjustment under Board's decision.		
Corrected depletion on petitioner's Coyote property as set forth in the depletion schedule attached hereto, marked petitioner's Exhibit "A".	$3,055,192.28	
Corrected depletion on petitioner's Whittier property as set forth in the depletion schedule attached hereto, marked petitioner's Exhibit "B"	158,531.08	
Total depletion under Board's decision	$3,213,723.36	

[222]

1918 (Continued)

Brought forward	$3,213,723.36	
Depletion allowed by the Commissioner in his Certificate of Overassessment	$2,252,147.48	
Additional depletion under Board's decision		$961,575.88
Loss for the year 1918		$592,692.56

1919		
Net income per 60-day letter		$333,140.09
Depletion adjustment under Board's decision.		
Corrected depletion on petitioner's Coyote property as set forth in the depletion schedule attached hereto, marked petitioner's Exhibit "A".	$2,778,494.22	
Corrected depletion on petitioner's Whittier property as set forth in the depletion schedule attached hereto marked petitioner's Exhibit "B".	193,521.34	
Total depletion under Board's decision	$2,972,015.56	
Depletion allowed by the Commissioner in 60-day letter	$2,072,660.49	
Additional depletion resulting from Board's decision		$899,355.07
Net loss for the year 1919		$566,214.98
1920		
Net income per 60-day letter		$944,589.18

[223]

1920 (Continued)

Brought forward		$944,589.18
Depletion adjustment under Board's decision.		
Corrected depletion on petitioner's Coyote property as set forth in the depletion schedule attached hereto, marked petitioner's Exhibit "A".	$2,263,874.73	
Corrected depletion on petitioner's Whittier property as set forth in the depletion schedule attached hereto, marked petitioner's Exhibit "B".	159,343.21	
Total depletion under Board's decision.	$2,423,217.94	
Depletion allowed by the Commissioner in 60-day lr.	1,689,645.13	
Additional depletion resulting from Board's decision	$ 733,572.81	
1919 net loss carried forward	566,214.98	
		$1,299,787.79
1920 taxable income.		None

1919

Tax previously assessed	None
Correct tax liability	None
Deficiency	None

1920

Tax previously assessed	None
Correct tax liability	None
Deficiency	None

[224]

Petitioner's Exhibit "A"

Murphy Oil Company

DEPLETION SCHEDULE

COYOTE

Year	$ Capital Sum Beg. of Year	Added	Total	Bbls. Reserves Added	Deducted	Total	Bbls. Production Free Oil	Royalty Oil	Total	Unit Cost	$ Depletion Sustained
3/1/13 to11/30/13			$15,710,899.52			41,191,605	—o—	428,351	428,351	.38141	163,377.35
12/1/13 to 12/31/13	15,547,522.17		15,547,522.17	30,572,440		10,190,814	—o—	18,432	18,432	1.52564	28,120.60
1914	15,519,401.57		15,519,401.57			10,172,382	142,329	125,256	268,085	1.52564	191,095.56
1915	15,328,306.01		15,328,306.01			9,904,297	144,836	279,379	424,215	1.54764	432,378.12
1916	14,895,927.89		14,895,927.89			9,480,082	149,719	670,213	819,932	1.57128	1,053,092.28
1917	13,842,835.61		13,842,835.61			8,660,150	161,675	1,410,707	1,572,382	1.59845	2,254,944.60
1918	11,587,891.01		11,587,891.01			7,087,768	167,622	1,868,722	2,036,344	1.634.91	3,055,192.28
1919	8,532,698.73		8,532,698.73			5,051,424	—o—	1,644,897	1,644,897	1.68916	2,778,494.22
1920	5,754,204.51		5,754,204.51			3,406,527	—o—	1,340,237	1,340,237	1.68916	2,263,874.73

NOTE: This schedule same as used for 60 day letter except that bonus is not deducted from Capital Sum.

[225]

Petitioner's Exhibit "B".

Murphy Oil Company

DEPLETION SCHEDULE

WHITTIER

Year	$ Capital Sum Beg. of Year	$ Capital Sum Total	Bbls. Reserves Added Deducted	Bbls. Reserves Total	Bbls. Production Free Oil	Bbls. Production Royalty Oil	Unit Cost	$ Depletion Sustained
3/1/13 to 11/30/13		1,450,207.08		5,983,443		291,902	.24237	70,748.29
2/1/13 to 12/31/13	1,379,458.79	1,379,458.79	4,268,656	1,422,885		6,492	.96948	6,293.86
1914	1,373,164.93	1,373,164.93		1,416,393	39,671	34,898	.96948	33,832.91
1915	1,339,332.02	1,339,332.02		1,341,824	37,664	72,658	.99814	72,522.85
1916		1,266,809.17		1,231,502	32,701	146,843	1.02867	151,052.99
1917		1,115,756.18		1,051,878	20,825	181,736	1.06072	192,771.00
1918		922,985.18		849,317	14,878	145,879	1.08673	158,531.08
1919		764,454.10		688,560		174,309	1.11022	193,521.34
1920		570,932.76		514,251		143,524	1.11022	159,343.21

NOTE: This schedule same as used for 60 day letter except that bonus is not deducted from Capital Sum.

[226]

(Title of Court and Cause.)

DECISION.

The Board having promulgated its opinion in the above entitled proceeding on March 30, 1929, and the petitioner having duly submitted its notice of settlement and recomputation under rule 50, which was set down and called for hearing on January 15, 1930, and it appearing that said recomputation, showing no deficiencies for the years 1919 and 1920, was uncontested by the respondent, it is

ORDERED and DECIDED: That there are no deficiencies for the years 1919 and 1920.

(Signed) LOGAN MORRIS,
Member, U. S. Board of Tax Appeals.

[Endorsed]: Entered Jan. 17, 1930.

A true copy: Teste

(Seal) B. D. Gamble,
Clerk U. S. Board of
Tax Appeals. [227]

[Endorsed]: Filed Jul. 11, 1930.

(Title of Court and Cause.)

PETITION FOR REVIEW

In the United States Circuit Court of Appeals and

ASSIGNMENT OF ERRORS.

Now comes Robert H. Lucas, Commissioner of Internal Revenue, by his attorneys, G. A. Youngquist, Assistant Attorney General, and C. M. Char-

est, General Counsel, Bureau of Internal Revenue, and respectfully shows:

I.

That he is the duly appointed, qualified, and acting Commissioner of Internal Revenue, appointed and holding his office by virtue of the laws of the United States; that the Murphy Oil Company is a corporation organized under the laws of the State of California whose home office is at Whittier, California, and whose return for Federal income and excess profits tax purposes for the calendar years 1919 and 1920 was made to the Collector of Internal Revenue for the Sixth California Collection District, whose office is located in Los Angeles, California, which is within the jurisdiction of the United States Circuit Court of [228] Appeals for the Ninth Circuit.

II.

The nature of the controversy so far as here pertinent is as follows, to-wit:-

The question is whether the depletable base of the lessor of an oil and gas lease is reducible in whole or in part by the amount of cash bonus payments received from the lessee on the ground that they constitute a return of capital in whole or in part, or whether such basis is not so reducible on the ground that such payments represent taxable income in their entirety and have no relation to depletion.

Respondent by an instrument dated December 1, 1913, leased certain oil properties to the Standard

Oil Company of California and in connection therewith received cash bonus payments aggregating $5,173,595.18. Certain oil and gas royalties were also reserved.

In computing the amount of depletion sustained by the respondent in connection with the said oil properties for the calendar years 1919 and 1920, the petitioner deducted from the capital sums returnable through depletion the amount of the aforesaid bonuses received by the respondent on the ground that they constituted a return of part of the respondent's capital investment in the oil properties.

By reason of this action (and other action not here pertinent) the petitioner duly notified the respondent of resulting income and excess profits tax deficiencies of $76,740.20 and $321,660.33 for the calendar [229] years 1919 and 1920 respectively.

From the determination of the petitioner, the respondent appealed to the United States Board of Tax Appeals, and the Board held that the cash bonus payments here in question constituted taxable income in their entirety and should not have been applied in any part by way of reducing the respondent's depletable base or capital investment in the oil properties.

Upon a recomputation of the respondent's tax liability, the Board held that there were no deficiencies in tax for the years 1919 and 1920.

The hearing before the Board was held on October 22, 1928. The interlocutory decision of the Board and its findings of fact and opinion were

promulgated March 30, 1929. The final order of redetermination to the effect that there were no deficiencies in tax for the years 1919 and 1920 was entered on January 17, 1930.

III.

That said petitioner, being aggrieved by the conclusions of law contained in said decision and by the said order of redetermination, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Ninth Circuit: *Wherefore,* he petitions that a transcript of record be prepared in accordance with the rules of the said United States Circuit Court of Appeals for the Ninth Circuit and transmitted to the Clerk of said Court for filing and appropriate action to the end that the errors complained of may be reviewed and [230] corrected by the said United States Circuit Court of Appeals for the Ninth Circuit.

IV.

That the petitioner's assignments of error are as follows:

1. The Board of Tax Appeals erred in holding that cash bonus payments to the lessor by the lessee of an oil and gas lease constitute income to the lessor in their entirety, and that no part of such payments represents recovery of capital by the lessor.

2. The Board erred in holding that no part of such cash bonus payments reduces the depletable base of the lessor.

3. The Board erred in holding that the Treasury Department Regulations covering the instant subject matter are a departure from the depletion concept, and in failing and refusing to follow said Regulations.

4. The Board erred in failing to find and to hold that such cash bonus payments in whole or in part represent a return to the lessor of its capital investment.

5. The Board erred in failing to find and to hold that the depletable base of the lessor is reducible by the amount of such cash bonus payments in whole or in part.

6. The Board erred in redetermining the respondent's 1919 and 1920 tax liability and finding and holding that there were no deficiencies in tax for those years.

7. The Board erred in failing and refusing to approve the deficiencies in tax for 1919 and 1920 as determined by the petitioner. [231]

8. The Board erred in its conclusion of law set forth in the opinion herein. Such conclusions were not responsive to its findings of fact and were contrary to and not supported by the evidence presented.

(Sgd) G. A. YOUNGQUIST,
Assistant Attorney General.
(Sgd) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
R. N. SHAW,
Special Attorney,
Bureau of Internal Revenue.

VERIFICATION.

District of Columbia.—ss.

C. M. Charest, being duly sworn, says that he is General Counsel for the Bureau of Internal Revenue and as such is duly authorized to verify the attached petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Board rendered herein; that he has read the said petition and is familiar with the statements therein contained; and that the facts therein stated are true except such facts as may be stated upon information and belief and those facts he believes to be true.

(Sgd) C. M. CHAREST.

Sworn and subscribed to before me this 10th day of July, 1930.

(Sgd) MARCELLETTE M. TAYLOR,
(Seal) Notary Public, District of Columbia.
My commission expires March 31st, 1935. [232]

[Endorsed]: Filed Jul 17, 1930.

(Title of Court and Cause.)

NOTICE.

To Charles B. McInnis, Esq.,
Shoreham Building,
Washington, D. C.

Please take notice that this office today lodged with the United States Board of Tax Appeals on behalf of the Commissioner of Internal Revenue a petition seeking a review of the Board's decision

herein by the United States Circuit Court of Appeals for the Ninth Circuit, a copy of which petition is hereto attached and served upon you.

Dated at Washington, D. C., this 11th day of July, 1930.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Receipt of the above and foregoing notice, together with a copy of the petition mentioned therein, is hereby acknowledged this 16th day of July, 1930.

(Sgd) CHAS. B. McINNIS,
Attorney of Record for
Respondent. [233]

[Endorsed]: Filed Jul 28, 1930.

(Title of Court and Cause.)

NOTICE.

To Murphy Oil Company,
Whittier, California.

Please take notice that this office today lodged with the United States Board of Tax Appeals on behalf of the Commissioner of Internal Revenue a petition seeking a review of the Board's decision herein by the United States Circuit Court of Appeal for the Ninth Circuit, a copy of which petition is hereto attached and served upon you.

Dated at Washington, D. C., this 11th day of July, 1930.

(Sgd) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Receipt of the above and foregoing notice, together with a copy of the petition mentioned therein, is hereby acknowledged this 15th day of July, 1930.

(Signed) MURPHY OIL COMPANY,
(Seal) Taxpayer.
By Kenyon F. Lee, Its Secretary. [234]

[Endorsed]: Filed Mar. 25, 1931.

(Title of Court and Cause.)

PRAECIPE FOR RECORD.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and certify to the clerk of the United States Circuit Court of Appeals for the Ninth Circuit within the time provided by the rules of that court in this respect, as extended, a transcript of record for review herein consisting of the following documents:

1. The docket entries of the proceedings before the Board.
2. Petition of the Murphy Oil Company filed April 24, 1926, together with the attached Exhibit "A" (60-day letter and statement dated February 6, 1926).
3. Amended petition of the Murphy Oil Company filed April 3, 1928, together with the taxpayer's motion for leave to file the amended petition, but omitting the attached exhibits.
4. Second amended petition of the Murphy Oil Company filed September 20, 1928, together

with the taxpayer's motion for permission to file the second amended petition, but omitting the attached Exhibit No. 1, for the reason that it is the same as Exhibit "A" referred to in "2", supra.

5. Answer of the Commissioner of Internal Revenue to the second amended petition.
6. Stipulation "1" filed October 22, 1928, together with all the Exhibits A to F, inclusive, and their parts, as referred to in said stipulation and filed. [235]
7. Findings of Fact, Opinion and Decision of the Board.
8. Notice of settlement under Rule 50, with the attached redetermination under Rule 50, including Exhibits A and B attached, filed by the taxpayer on December 7, 1929.
9. Petition for review and notice of filing, with acknowledgment of service.
10. This praecipe.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,
Washington, D. C.

Washington, D. C., March 25, 1931. [236]

(Title of Court and Cause.)

CERTIFICATE.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 236, inclusive, contain and are a true

copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 29th day of April, A. D. 1931.

(Seal) B. D. GAMBLE, Clerk.

[Endorsed]: No. 6459. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Murphy Oil Company, a Corporation, Respondent. Transcript of the Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed May 6, 1931.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.
By FRANK H. SCHMID,
Deputy Clerk.

Nos. 6388 and 6459

United States

Circuit Court of Appeals

For the Ninth Circuit.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

and

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

MURPHY OIL COMPANY, a Corporation,
Respondent.

Upon Petitions to Review an Order of the United States Board of Tax Appeals.

PROCEEDINGS HAD IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

In the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6388.

MURPHY OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION TO CONTINUE APPEAL FOR ARGUMENT.

Counsel for the respondent having so requested, it is hereby stipulated and agreed by and between the parties to the above-entitled cause, through their respective attorneys, that this appeal may be continued for hearing from June 10, 1931, to the October, 1931, term, of this Honorable Court. It is further agreed that this cause may be assigned for argument and heard at the same time as the appeal entitled "Commissioner of Internal Revenue vs. Murphy Oil Company," C.C.A. No. 6459.

As grounds for this request, it is shown to the court that the petitions for review prosecuted to this court in the instant case and also in the appeal entitled "Commissioner of Internal Revenue vs. Murphy Oil Company," C.C.A. No. 6459, grow out of the same case before the United States Board of Tax Appeals, and since the transcript of record in the latter case has not yet been printed, it is desired, for the convenience of counsel, that the hear-

ing of the above-entitled cause be continued to the October term and that both cases be assigned for argument on the same date.

RANDOLPH E. PAUL,
Attorney for Petitioner.
C. M. CHAREST,
Attorney for Respondent.

May 13, 1931.

So ordered.

CURTIS D. WILBUR,
Senior U. S. Circuit Judge.

[Endorsed]: Stipulation to Continue Appeal for Argument. Filed May 18, 1931. Paul P. O'Brien, Clerk.

At a stated term, to wit, the October term, A. D. 1931, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the city and county of San Francisco, in the State of California, on Tuesday, the eighth day of December, in the year of our Lord one thousand nine hundred and thirty-one. Present: Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding; Honorable WILLIAM H. SAWTELLE, Circuit Judge; Honorable WILLIAM P. JAMES, District Judge.

[Title of Cause.]

ORDER OF SUBMISSION.

ORDERED above causes argued by Mr. Thomas

R. Dempsey, counsel for Murphy Oil Company, a corporation, and by Mr. John G. Remey, Special Assistant Attorney General, counsel for Commissioner of Internal Revenue, and submitted to the Court for consideration and decision.

At a stated term, to wit, the October term, A. D. 1931, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the city and county of San Francisco, in the State of California, on Monday, the eleventh day of January, in the year of our Lord one thousand nine hundred and thirty-two. Present: Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding; Honorable WILLIAM H. SAWTELLE, Circuit Judge; Honorable PAUL J. McCORMICK, District Judge.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the Court, ORDERED that the typewritten opinion this day rendered by this Court in the above cases be forthwith filed by the Clerk and that a judgment be filed and recorded in above causes in accordance with the opinion filed.

United States Circuit Court of Appeals for the Ninth Circuit.

No. 6388.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent,

and

No. 6459.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

MURPHY OIL COMPANY, a Corporation,
Respondent.

OPINION U. S. CIRCUIT COURT OF APPEALS.

Petitions to Review Orders of the U. S. Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit JJ., and JAMES, District J.

WILBUR, Circuit Judge.—Two petitions have been presented to review a determination of the Board of Tax Appeals. That by the Commissioner claims that by the order of the Board with reference to bonus, payments by the lessee, aggregating

$5,173,595.18, were improperly applied by the Board in estimating the depletion, properly deductible, from the income for the years 1919 and 1920. That by the taxpayer claims an error in regard to the application of the cost and expense of a lawsuit and of money paid in settlement of the same, amounting in the aggregate to $1,370,877.24 ($1,200,000, being the amount paid in settlement and $170,877.24 being the cost and expenses of the litigation). This suit involved only the Coyote property belonging to petitioner. The net income of the taxpayer for these years subject to depletion deductions was respectively $2,636,882.78 and $2,988,550.51.

The facts involved were determined by the Board of Tax Appeals and also appear in part from the computation of tax made by the Commissioner of Internal Revenue by order of the Board in pursuance of their rule 50. This computation of the depletion which is in effect the decision of the Board is to be found in the margin, p. 270.* The facts are undisputed.

In 1903 Simon J. Murphy, petitioner's predecessor, obtained an oil lease of 2,240 acres of land owned by Domingo Bastanchury and in 1904 assigned and transferred this lease to petitioner, Murphy Oil Company. An oil-well was drilled on the land under this lease, but it was capped. The widow of Domingo Bastanchury, as the administratrix of his estate, later claimed in the litigation involved herein that this well was represented to him to be a dry hole when in fact oil was discovered

therein and that he sold the land with that belief. In December, 1904, E. W. Bacon, then secretary of the Murphy Oil Company, purchased the fee in the land from Domingo Bastanchury at $35 an acre, for $78,400, and leased the surface rights to Bastanchury. In January, 1905, Bacon and his wife granted and conveyed the said land to the petitioner, the Murphy Oil Company. Thereafter oil development on the property proceeded and oil was produced in paying quantities.

On December 1, 1913, the petitioner leased the land, which was thereafter known as the Coyote

*

PETITIONER
MURPHY O
DEPLETI

COYOTE

Year	Beg. of Year	$ Capital Sum Added Total	Bbls. Reserves Added Deducted	Total
3/1/13 to 11/30/13		$15,710,899.52		41,191,9
12/1/13 to 12/31/13	15,547,522.17	15,547,522.17	30,572,440	10,190,9
1914	15,519,401.57	15,519,401.57		10,172,9
1915	15,328,306.01	15,328,306.01		9,904,9
1916	14,895,927.89	14,895,927.89		9,480,9
1917	13,842,835.61	13,842,835.61		8,660,9
1918	11,587,891.01	11,587,891.01		7,087,9
1919	8,532,698.73	8,532,698.73		5,051,9
1920	5,754,204.51	5,754,204.51		3,406,9

project, to the Standard Oil Company of California, together with land thereafter known as the Whittier property. A bonus of $5,173,595.18 was paid for the lease on these two oil properties, which bonus was apportioned by the Commissioner to these properties in the sum of $4,517,402.70 and $656,192.48, respectively. Hereinafter only the depletion of the Coyote property as affected by the portion of the bonus allocated to that property will be considered in detail, but the same principles are also applicable to the depletion of the Whittier property.

The Commissioner of Internal Revenue fixed the

XHIBIT "A"
OMPANY.
CHEDULE.

Free Oil	Bbls. Production Royalty Oil	Total	Unit Cost	$ Depletion Sustained
——	428,351	428,351	.38141	163,377.35
——	18,432	18,432	1.52564	28,120.60
142,829	125,256	268,085	1.52564	191,095.56
144,836	279,379	424,215	1.54764	432,378.12
149,719	670,213	819,932	1.57128	1,053,092.28
161,675	1,410,707	1,572,382	1.59845	2,254,944.60
167,622	1,868,722	2,036,344	1.63491	3,055,192.28
——	1,644,897	1,644,897	1.68916	2,778,494.22
——	1,340,237	1,340,237	1.68916	2,263,874.73

value of the land, referred to as "Coyote," on March 1, 1913, at $15,710,899.52 and the recoverable oil content of the land on that date at 41,191,605 barrels, and thus fixed the value of the recoverable oil in the ground at 38.141 cents per barrel. The Commissioner fixed the value of the land at the time of the execution of the lease to the Standard Oil Company on December 1, 1913, the terms of which are involved in this proceeding, as $15,547,522.17. This value was that fixed for the land on March 1, 1913, less the value of the oil produced therefrom at 38.141 cents per barrel up to December 1, 1913, the date of the lease, that is, less $163,377.35. Under the direction of the Board of Tax Appeals in its decision and in opposition to the views entertained by the Commissioner on the subject as determined by the deficiency tax, the Commissioner also fixed this amount ($15,547,522.17) as the value of the land in December, 1913, after the execution of the lease and subject to the lease. Thus, upon the execution of the lease, the Commissioner, in compliance with the order of the Board, raised the value of the recoverable oil belonging to, or payable as royalty to, the petitioner to $1.52564 per barrel, that is, four times $0.38141. This figure was arrived at by subtracting from the total recoverable mineral content of 41,191,605 barrels, less 428,351 barrels already recovered, three-fourths thereof, to wit, 30,572,440 barrels, and leaving as the recoverable portion belonging to the petitioner, as royalty oil, 10,190,814 barrels. The value of this royalty oil was taken as equal to the value of the land prior to the execution of the lease,

thus giving as the value of each barrel of royalty oil $1.52564. It seems absurd on its face to estimate the value of the royalty oil in the ground at the time of the execution of the lease at 38.141 cents, and immediately thereafter at $1.52564, but the absurdity disappears when it is observed that the $1.52564 represents oil brought to the surface, and that the difference between the 38.141 cents and the $1.52564 represents the cost to the petitioner of bringing the oil to the surface, that is, it cost petitioner three barrels of oil at 38.141 cents to bring a barrel of oil to the surface which was worth 38.141 cents in the ground, and $1.52564 at the surface. "Worth" in this connection meaning capital investment. But the actual depletion of the value of the land as of March 1, 1913, by the recovery of oil therefrom was nevertheless four barrels of oil at 38.141 cents for each barrel of royalty oil recovered for the petitioner. In these statements we are ignoring for the present the added cost of extraction due to the consumption of oil by the lessee in its work of development and production which was known as "free oil." In considering the reasonableness of this figure of $1.52564 as representing the portion of petitioner's capital investment in the oil recovered as royalty to be deducted from the total receipts actually derived from the royalty oil in determining the proportion thereof which was petitioner's income and assuming, as the Commissioner and the Board of Tax Appeals held, that the market value of the property on November 30, 1913, was $15,547,522.17,

it should be observed that the owner of the land had several methods of reducing its capital to money. This it could do by selling the property for its market value, which was the same as March 1, 1913, less depletion, in which event the purchase price would not be subject to income tax because it would merely represent a change in form of capital, or it could continue the operations it was already engaged in for the bringing of the oil to the surface. Instead of doing either, it could enter into a lease or contract with a third party by which the third party undertook to bring the oil to the surface and sell it or turn it over to the petitioner. This would reduce the amount of oil which the owner would be entitled to sell at market prices, but, depending upon the market price of oil, might or might not increase his income. The effect of the lease as determined by the Board of Tax Appeals (ignoring the question of bonus for the moment) was that the owner paid from the oil content of the soil 30,572,440 barrels of oil, plus the free oil allowed to the tenant under the lease, as the expense of bringing to the surface the remaining recoverable oil it was to receive. Under these circumstances it no doubt would be a reasonable adjustment of the relationship of the landlord and tenant with reference to depletion to fix $1.52564 as the capital investment on March 1, 1913, in each barrel of royalty oil brought to the surface and to allow this whole amount to the landlord as his depletion, the tenant having no capital investment at this time (March 1, 1913) and on this hypothesis it would be entitled to no depletion allowance.

We are here met with the difficulty in the case arising from the payment of a bonus of $4,517,402.70, which was determined by the Commissioner in one way and by the Board of Tax Appeals in the other. The lessee agreed to pay this money in installments extending over a period of five years aggregating $4,517,402.70, regardless of whether or not any oil was produced from the property during that period. This amount the Board of Tax Appeals determined to be income to the landlord taxable as such during the years in which it was paid, but the Commissioner had determined the entire bonus to be a return of capital investment to the landlord (with certain minor deductions hereinafter referred to), that is to say, the Commissioner in effect held that the petitioner did not pay 30,572,440 barrels of oil in the ground valued at 38.141 cents per barrel to the lessee for bringing petitioner's royalty oil to the surface (that is, $11,660,634.34 worth of oil for that purpose), but paid that amount less the bonus of $4,517,402.70, to wit, $7,143,231.64. By this process of reasoning the Commissioner came to the conclusion that the amount of petitioner's capital invested in its royalty oil in the ground was about $1.08236 per barrel. Consequently, the point involved here resolves itself into the question whether or not $1.52564 or $1.08236 should be deducted from the selling price of each barrel of royalty oil recovered during the years 1919 and 1920, as the petitioner's capital investment therein of March 1, 1913.

The determination by the Board of Tax Appeals

as to the depletion of the property due to the production of oil is predicated upon the proposition that when the petitioner shifted his position from that of owner to that of landlord the value of his interest remained exactly the same, notwithstanding that he had received $4,517,402.70 in cash from his investment as of March 1, 1913. Now, it is obvious that if the land in fee was worth $15,547,522.17 immediately before the lease and that if the lease was a reasonable one to be made at the time, that is, so reasonable that it did not depreciate the value of the capital investment of the landlord in the land, he could have sold the land subject to the lease for exactly the same sum for which he could have sold the land without the lease, namely, $15,547,522.17, but a sale under these circumstances would of course give to the purchaser the right to the bonus payments of $4,517,402.70. If the landlord insisted upon reserving to himself these bonus payments, it is obvious that under the circumstances he could not hope to get more for the land subject to the lease than the $11,030,119.47 cash, which represented his capital investment in the recoverable royalty oil. It would seem then that the interest of the landlord in the royalty oil at the surface would be his proportion of the recoverable content of 10,190,814 barrels at a price to equal $11,030,119.47, which would be $1.08236 per barrel.

Thus far we have discussed on principle rather than on authority the depletion allowance to the landlord upon the relative bases adopted by the

Board of Tax Appeals and the Commissioner, as to the capital investment of the landlord in each barrel of recoverable royalty oil, which leads us to the conclusion that the Commissioner was right and the Board of Tax Appeals was wrong, but there is an entirely different line of approach to the subject, which leads more definitely and more authoritatively to the same conclusion, in the light of legislation, regulations and decisions on the subject heretofore rendered. We will now consider the subject from that angle. The subject under consideration has been of sufficient importance to invoke the action of Congress in its revenue laws and has been the subject of rules and regulations adopted by the Commissioner and is involved in many judicial decisions. Originally the method of fixing the depletion allowance for oil properties under the revenue law of 1913 was a fixed percentage of the value of the oil recovered, to wit, 5 per cent (sub. G (b), § II, Revenue Act of 1913; 38 Stat. 114, 166). In 1918 the revenue law was passed which was in force at the time of the taxable years 1919 and 1920, now under consideration. That law applicable to depletion is as follows:

> "Sec. 214 (a) That in computing net income there shall be allowed as deductions: * * *
>
> (10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based

upon cost including cost of development not otherwise deducted: PROVIDED, that in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: PROVIDED FURTHER, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such a reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * * ."

Revenue Act of 1918, c. 18, 40 Stat. 1057. See, also, § 234 (a)-(9) Id.

It is to be observed that the statute quoted provides for a reasonable allowance for depletion of the oil content of oil land "based upon costs, including cost of development not otherwise deducted." Now the cost of the land in the case at bar was $78,400. The cost of development is not shown by the record, but Congress further provided

in regard to lands situated as the land in the case at bar, "that in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be deducted in lieu of costs up to that date." So that in effect, as applicable to the case at bar, the law requires that the depletion allowance shall be "based upon the fair market value of the property on March 1, 1913, ($15,710,899.50) and the cost of development not otherwise deducted." The statute further provides: "Such reasonable allowances, in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. *In case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee.*" (Italics ours.)

The Supreme Court has had occasion to consider the right to a depletion allowance of a lessee upon a royalty basis of two tracts of mining land situate in Minnesota. Lynch vs. Alworth-Stephens Co., 267 U. S. 364. This lessee, in the case cited, who was to pay a royalty of 30 cents a ton for iron ore produced, had sublet one of the tracts upon a royalty basis of 75 cents a ton and the other 60 cents a ton. He was thus in the dual position of lessee and lessor. The Supreme Court held that he had a property right in the property and an interest therein (a "depletable base," to use the terminology of the briefs) within the meaning of the revenue laws of the United States. (§ 12–A,

Revenue Act of 1916, 39 Stat. 756, 757.) In that regard, Justice Sutherland, speaking for the court, said:

> "It is, of course, true that the leases here under review did not convey title to the unextracted ore deposits, U. S. v. Biwabik Mining Co., 247 U. S. 116, 123; but it is equally true that such leases, conferring upon the lessee the exclusive possession of the deposits and the valuable right of removing and reducing the ore to ownership, created a very real and substantial interest therein. See Hyatt v. Vincennes Bank, 113 U. S. 408, 416; Ewert v. Robinson, 289 Fed. 740, 746–50. And there can be no doubt that such an interest is property. Hamilton v. Rathbone, 175 U. S. 414, 421; Bryant v. Kennett, 113 U. S. 179, 192.
>
> * * * * * * * *
>
> "We agree with the circuit court of appeals, 294 Fed. 194, that, 'The plain, clear and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to every one whose property right and interest therein has been depleted by the extraction and disposition "of the product thereof which has been mined and sold during the year for which the return and computation are made." And the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study

of an acute and powerful intellect would discover.'

"It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy in the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. While respondent does not own the ore deposits, its right to mine and remove the ore and reduce it to possession and ownership is property within the meaning of the general provision. Obviously, as the process goes on, this property interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same mines is likewise lessened. There is an exhaustion of property in the one case as in the other; and the extent of it, with *the consequent deduction to be made, in each case is to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered*" (pp. 369, 370). (Italics ours.)

According to this very clear exposition of the Revenue Act of 1916 (39 Stat. 756, 757, §§ 2, 10, 12a), which is unambiguous, the lessee as well as

the lessor of the oil properties was entitled to a depletion allowance. The regulations of the Treasury Department (Reg. 33, Art. 170) under the Revenue Act of 1916 provided for the method for ascertaining and apportioning the allowance for depletion of oil property to the lessor and lessees of such property where a bonus has been paid substantially as was done by the Commissioner in the case at bar under the Act of 1918.

The Revenue Law of 1918, on the subject hereinabove quoted, allowed larger discretion to the Commissioner of Internal Revenue in ascertaining the annual depletion to be allowed, but expressly required that the depletion allowance should be "equitably apportioned between the lessee and lessor." (§ 214–a (10), above quoted.) The allowance of the total depletion to the lessor, as was required by the decision of the Board of Tax Appeals, left nothing to be apportioned to the interest of the lessee in the property. It can hardly be doubted that from the standpoint of the lessee the bonus payments represented invested capital and it is so provided by Treasury Regulations 45, Article 215 (hereinafter quoted in full), wherein it is provided that "The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition." As the total value of the oil in the ground in the Coyote property was $15,547,522.17, it is obvious that the lessee, by the payment of the bonus of $4,517,402.70, had an interest in each of the 40,763,254 barrels of oil in the ground of

about one-third the value thereof, or, to be accurate, 11.083 cents, and that the lessees capital investment is decreased to that extent by each barrel of oil brought to the surface. It would follow as an ancillary proposition that the capital investment or at any rate the depletion allowance of the lessor in each barrel of oil in the ground, as of the date of the lease, would be accordingly decreased, that is, would be 27.058 cents. That is to say, for the purpose of determining depletion and apportioning the amount thereof between the lessor and the lessee under the statute and the rules and regulations of the Treasury Department, the lessee has a depletion interest in each barrel of oil produced of 11.083 cents which cannot properly be allowed to the lessor. The Supreme Court has repeatedly passed upon this principle.

The Supreme Court in Burnett vs. Thompson Oil & Gas Co., 283 U. S. 301, had occasion to consider the depletion allowance for oil properties acquired before March 1, 1913, under the Revenue Act of 1918. The taxpayer was contending for a depletion allowance which should make up for inadequate depreciation allowances in previous years under former revenue acts upon the theory that the taxpayer was entitled during the life of his lease to recover by way of depletion the full amount of his capital investment. That is to say, the taxpayer was contending for depletion allowance for the taxable years during the remainder of the term, which would cover the actual depletion between March 1, 1913, and December 31, 1915, $91,686.15, whereas he had been actually allowed during that

period under the revenue laws only $6,322.02. It was conceded that the entire question was one of statutory construction. The Commissioner of Internal Revenue, acting under the regulations of the Department, had determined the depletion suffered during the taxable year by estimating the invested capital at the beginning of the year as of the value of March 1, 1913, less the actual depletion theretofore sustained, that is, less the $91,686.15 above referred to. The Commissioner had limited the depletion allowance for the taxable year to the actual depletion sustained during the taxable year, in accordance with the decision in Lynch vs. Alworth-Stephens Co., *supra,* construing the Revenue Law of 1916. The Supreme Court sustained the ruling of the Commissioner, thus holding that the action of the Commissioner limiting the depletion allowance to the actual depletion during the taxable year was a proper interpretation of the Revenue Law of 1918, as well as that of 1916. The court stated (page 306):

> "The nature of the tax as one for annual periods has been repeatedly mentioned in dealing with its application in various situations. The taxable year 1918, and that only, is involved, and deductions applicable to that year only should be allowed."

In the case at bar we are therefore dealing with the depletion allowance for the years 1919 and 1920 only, and the allowance is limited to the actual depletion during those years, under the Revenue Law of 1918, as was also the case under the

Revenue Law of 1916, which was 6,579,588 bbls. and 5,360,948, respectively.

We turn now from the consideration of the statute and of the decisions of the Supreme Court to the rules and regulations of the Treasury Department. The Commissioner adopted regulations in pursuance of the statute (No. 45, Art. 215) as follows:

> "Art. 215. Depletion—Adjustments of accounts on bonus or advanced royalty.—(a) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

This Regulation was amended by Article 216, Regulations 69, to read as follows:

> "Art. 216 (215). Depletion—Adjustments of accounts based on bonus or advanced roy-

alty.—(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

Under this rule for the allowance of depletion to the lessor as result of bonus payments and expressing the anticipated net market price of oil as X, the amount would be expressed by the formula:

$$\text{Depletion deduction to lessor} = \frac{\$4,517,402.70}{(X \times 10,190,814 + \$4,517,402.70)} \text{ of } \$15,547,522.17$$

It will be observed that the effect of this method of deducting a bonus is to put the bonus on a par with the actual receipts from the sale of oil by assuming that the bonus contains the same element of profit or income to the landlord that would be derived from the sale of oil recovered by royalty.

The Board of Tax Appeals held that the bonus was not return of capital in whole or in part, but was income, and that to consider such bonus in fixing depletion allowance was a departure from the depletion concept, and therefore the regulation

of the Commissioner, which treated the bonus as a partial return of capital, was void because in conflict with the statute in relation to taxable gains. In order to make the proposition involved more clear, we quote as follows from the opinion of the Board of Tax Appeals:

> "The respondent confesses error to the extent that he failed to follow the regulation. It remains for us to test the validity of the rule therein promulgated. In Nelson Land & Oil Co., 3 B. T. A. 315, we made it clear that, in our opinion, such a bonus received by a lessor was not a return of capital but is an advance rental or royalty and is taxable as income. That case was followed in R. H. Hazlett, 10 B. T. A. 332, and we are not cited and have been unable to find any authority to the contrary. See also Henry L. Berg, 6 B. T. A. 1287; John T. Burkett, 7 B. T. A. 560; D. R. McDonald, 7 B. T. A. 1078; and R. H. Hazlett, *supra,* in which we held that such bonuses were not gains derived from the sale of 'capital assets' under the capital gain provisions of the 1921 Act.
>
> "The bonus payment in the instant case was a part of the consideration paid for the lease. While expected production undoubtedly was considered in fixing the amount of the bonus, it is elementary under the laws governing such agreements that its payment did not, in any wise, depend upon, or relate to, production. The lessee's liability therefor was fixed by the

terms of the contract. On the other hand, the operation of the principle of depletion depends upon exhaustion of resources through production—i. e., the recovery of capital through its conversion from the form of oil resources or reserves into marketable products or the equivalent received for such product. Under such principle the depletion allowance for the year or years of the bonus payments can only be measured by reference to the oil produced. If, as we have pointed out, the bonus is income, no part of which represents recovery of capital, it follows that any depletion allowance against such income is a departure from the depletion concept. The regulation relied on by the respondent is clearly such a departure. While it might, in some cases at least, produce a more equitable result, the statutory allowance may not be so varied by administrative regulation." Murphy Oil Co. vs. Commissioner of Internal Revenue, 15 B. T. A. 1195.

For the same reason we also quote the decision of the Board in Nelson Land & Oil Co., 3 B. T. A. 315, cited in the foregoing excerpt from the opinion of the Board:

"Why a 'bonus or other sum in addition to royalties' forming a part of the consideration for the lease should be regarded as a return of capital any more than the royalties is beyond our comprehension. It would be just as logical to hold that the royalties, to the extent of the capital remaining to be recovered by the lessor,

constitute a return of capital. The method prescribed by the statute of returning to a corporate taxpayer its capital investment, free from taxation, is through the depletion allowance provided for by section 234 (a) (9) of the Revenue Acts of 1918 and 1921. A bonus paid under such circumstances is as much a part of the consideration as the royalties. It is in fact and in substance a part of the royalties" (pp. 325–6).

The Board in that case quoted from the decision of the Supreme Court in Work vs. United States ex rel. Mosier, 261 U. S. 352, with reference to a bonus paid for an oil and gas lease upon lands belonging to members of the Osage Tribe as follows:

> "It was in effect a supplement to the royalties already determined. It was really part of the royalty or rental in a lump sum or down payment. We do not see how it can be classified as anything else. It was income from the use of the mineral resources of the land. Of course, it involved a consumption and reduction of the mineral value of the land, but so does a royalty. This is an inevitable characteristic of income from the product of the mine."

The position of the Board in this case is to the effect that the bonus does not come within the provisions of the statute in reference to capital gain and that it must therefore be treated as income notwithstanding the provisions of the statute and of the regulations regarding depletion allowances. It will also be observed that the Board classified bonus as

identical with royalty oil and that neither could justly be regarded as return of capital, while the whole theory of the depletion allowance is that the proceeds derived from the sale of royalty oil is of necessity in part a return of capital. It is the only manner in which the capital represented by the oil will be returned to the lessor, and for that reason is subject to a depletion allowance. The depletion allowance under the ruling of the Commissioner in this case was made to the taxpayer upon the theory that although its royalty amounted to over two million dollars a large portion of that royalty constituted a return of capital which was allowed to it under the statute to compensate for the depletion of its oil reserve. The question in this case is the amount per barrel to be allowed to the petitioner as its returned capital and this must be determined by ascertaining, as the law provides, the fair market value of the property on March 1, 1913, and by allowing a reasonable allowance for depletion based in part upon that property value. The theory upon which the Commissioner has proceeded in fixing petitioner's tax under the regulations of the Treasury Department is that the taxpayer is entitled to the return of his entire capital in the form of bonuses and royalties, and that his liability for tax upon the income is upon the balance of the income derived from the property after deducting the installment of capital included in the royalty oil. The regulation is not only in conflict with the statute, but directly conforms thereto. The statute with reference to depletion of oil properties is a special one with reference to the particular subject

of oil leases involving the production of oil and minerals from mines, and the consequent return of capital by the owners of interests therein, and controls over other general provisions of the law in regard to the return of capital investments.

We hold that the Commissioner correctly determined that at least a part, if not all, of the bonus payment is to be treated as return of capital. The burden is on the taxpayer to show that the computation of tax by the Commissioner is erroneous, and there is a failure of proof in this case sufficient to permit allocating a part of the bonus payment to return of capital and part to income, under the above quoted regulation (Reg. 45, Art. 215, as amended). An essential element of proof in order that a tax might be determined in accordance with the regulations of the Treasury Department was proof of the probable market value of the oil to be marketed under the lease in terms of dollars per barrel, and this data not having been furnished by the taxpayer it failed to prove that it is entitled to have any part of the bonus treated as income rather than a return of capital. Thus, upon the record in this case, either all of the bonus payment is to be treated as a return of capital or none of it is, and the appeal has been so presented by the petitioner. The Commissioner must therefore be sustained in his estimate of the tax.

In view of our conclusion with regard to the relation of the bonus to the depletion allowance, it will be necessary to consider the petition of the taxpayer to review action of the Board on the ground that it erred in treating the payment in settlement

of litigation and the expense thereof as a capital expenditure.

The administratrix of the estate of Domingo Bastanchury, Maria Bastanchury, brought a suit to recover from petitioner the 2,240 acres of land sold by her husband to the petitioner's vendor, offering to restore the purchase price of $78,400, upon the ground that the property was obtained by fraudulent concealment of the fact that the oil-well sunk by petitioner's vendor was successful and that the decedent therefor sold the land for an inadequate consideration because of such concealment. In order to toll the statute of limitations, it was alleged that the fraud was discovered within the statutory period. The substance of the allegation from the standpoint now under consideration was that the petitioner's predecessor had acquired the title to the property without paying an adequate consideration for it, which it in equity still owed. The remedy invoked was that of rescission and as an incident to rescission a recovery of the proceeds derived from the sale of oil extracted therefrom.

The defrauded vendor had the right thus to rescind, if the allegations were true, or to confirm the sale and sue for damages for the fraud. This damage would no doubt be measured by the difference in the value of the thing sold, as it was believed by the vendor, and its actual value. See, Hines vs. Brode, 168 Cal. 507. While the suit was one to rescind, the settlement thereof for a money consideration necessarily involved a confirmation of the sale and a payment of damages for the fraud in an amount fixed by agreement

instead of by decree of Court by way of compensation for the land. While the difference between the value received by the vendor and the value of the land at the time of the transaction, judging from its appraised value in the case at bar, must have been much more than the amount received in settlement, it does not alter the fact that the payment made to the vendor was substantially a deferred payment for the property. It was therefore essentially a capital investment and not allowable as a deduction from income. Moreover, in fixing the tax of the petitioner it already had been given the benefit of the full market value of the property as of March 1, 1913, upon the theory that it owned the property at that time. The $1,200,000 therefore was not only not a proper deduction from the income because it was a capital expenditure, but it should not be added to the capital in determining the depletable base, for that had already been fixed by the statute as a fair market value of the property on March 1, 1913, and this estimated value included the entire property, including, of course, the interest therein which was still owned by Domingo Bastanchury and which was in effect subsequently acquired by petitioner by the payment of the additional purchase money. If the money paid in settlement of the litigation is not a proper addition to capital investment, neither is the $32,151.77 expended in 1918, nor the $170,877.24 expended in 1919 as attorneys' fees and costs of the litigation. We therefore agree with the conclusion of the Board of Tax Appeals on this subject, which was as follows:

"To the extent that the expenses and payment were incurred and made in defense of the claim against the oil properties they were capital expenditures. We have repeatedly held that the cost of defending title, whether in the form of legal fees or compromise payments, is a capital expenditure representing additional cost of the property. Lincoln L. McCandless, 5 B. T. A. 1114; Gopher Granite Co., 5 B. T. A. 1216; Seletha O. Thompson, 9 B. T. A. 1342; Frederick McLean Bugher, *supra;* North American Oil Consolidated, 12 B. T. A. 68; Phoenix Development Co., 13 B. T. A. 414. The decisions in Kornhauser v. U. S., *supra,* and the Superheater Co., 12 B. T. A. 5, which are relied upon by the petitioner, are not in conflict with these cases. In the Superheater case the contemplated litigation grew out of an action of the board of directors, acting as such. The claim settled did not involve title. In the Kornhauser case the legal expenses were incurred to contest a claim against income received, differing fundamentally from the ordinary attack on title, even though the income in question consisted of shares of stock.

"In view of such conclusion we must reject petitioner's contention that the total deductions claimed should be allowed. We can not allow the total and it would be idle for us to further consider whether any part of such total (i. e., that portion allocable to the defense and settlement of the claim for accounting) is allow-

able as the record furnishes no basis for the apportionment of the whole among the several claims defended or settled.

"The petitioner's contention that if the litigation and settlement costs are not deductible they must represent capital expenditures to be added to the amortizable capital value, must likewise be rejected."

We refrain, however, from determining whether or not a portion of the amount paid in settlement and a portion of the attorney fees in the action was to be properly apportioned to the defense of the title, and another portion to the defense of the claim to recover proceeds derived from the land. As stated by the Board of Tax Appeals, there is no basis for making such allocation, even assuming that such an allocation could or should be made, if there were sufficient evidence upon which to base it. We therefore express no opinion upon the propriety of such allocation, although, as we have indicated, we are inclined to the view that none should be made. The order of the Board of Tax Appeals is reversed as to bonus deductions and affirmed as to attorneys' fees, costs and settlement, and the determination of the Commissioner is affirmed.

[Endorsed]: Opinion. Filed Jan. 11, 1932. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit.

Nos. 6388–6459.

MURPHY OIL COMPANY, a Corporation,
Petitioner and Cross-Respondent,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Cross-Petitioner.

JUDGMENT U. S. CIRCUIT COURT OF APPEALS.

Upon Petitions to Review an Order of the United States Board of Tax Appeals.

This cause came on to be heard on the transcripts of the record from the United States Board of Tax Appeals and was duly submitted.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court, that the order of the said Board of Tax Appeals in these causes be, and hereby is reversed, and that these causes be, and hereby are remanded to the said Board of Tax Appeals, with directions to disallow the claims of Murphy Oil Company as to bonus deductions and as to attorneys' fees, costs and settlement, and to enter a redetermination of tax deficiencies for the years 1919 and 1920 in accordance with the determination of the Commissioner of Internal Revenue.

[Endorsed]: Judgment. Filed and entered January 11, 1932. Paul P. O'Brien, Clerk.

Filed Jan. 15, 1932. Paul P. O'Brien, Clerk.

At a stated term, to wit, the October term, A. D. 1931, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the city and county of San Francisco, in the State of California, on Tuesday, the twenty-third day of February, in the year of our Lord one thousand nine hundred and thirty-two. Present: Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding; Honorable WILLIAM H. SAWTELLE, Circuit Judge.

[Title of Cause.]

ORDER DENYING PETITIONS FOR A REHEARING.

Upon consideration thereof, and by direction of the Court, IT IS ORDERED that the petitions of Murphy Oil Company, filed in each of above causes on February 8, 1932, for a rehearing of each of above causes be, and each of them hereby is denied.

United States Circuit Court of Appeals for the Ninth Circuit.

Nos. 6388–6459.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent;

and

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

MURPHY OIL COMPANY, a Corporation,
Respondent.

ORDER STAYING ISSUANCE OF MANDATE.

Upon application of Messrs. Dempsey & Mackay, counsel for the petitioner, and good cause therefor appearing, IT IS ORDERED that the issuance, under Rule 32, of the mandate of this court in the above causes be, and hereby is stayed to and including May 2, 1932; and in the event the petition for a writ of certiorari to be made by the petitioner herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

CURTIS D. WILBUR,
United States Circuit Judge.

Dated: San Francisco, California, February 26, 1932.

In the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6388.

MURPHY OIL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPLICATION FOR STAY OF MANDATE.

To the Honorable CURTIS D. WILBUR, WILLIAM H. SAWTELLE and WILLIAM P. JAMES, Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes Murphy Oil Company, the petitioner in the above-entitled cause, and moves the Court to enter an order withholding the issuance of the mandate in this case because it is the *bona fide* intention of the petitioner to make proper application to the Supreme Court of the United States for a writ of certiorari in this case within the time permitted by the rules of the Supreme Court of the United States, and in support hereof petitioner attaches the professional statement of its counsel, A. Calder Mackay of Los Angeles, California.

Petitioner's counsel are located in Los Angeles and New York which fact makes it necessary for

counsel to communicate by writing and telegraphing with respect to the preparation of the petition for writ of certiorari and the supporting brief. Such consultation between petitioner's counsel will require more time than is ordinarily required where counsel are in the same city, and therefore it is respectfully requested that the mandate be stayed for at least a period of sixty (60) days.

Dated this 25th day of February, 1932.

RANDOLPH E. PAUL.
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Of Counsel.

I hereby certify that it is the *bona fide* intention of the petitioner to petition the Supreme Court of the United States for a writ of certiorari, within the time and as permitted by the rules of the Supreme

Court of the United States and that I believe there is merit in its case and that the judgment of the United States Circuit Court of Appeals ought to be reversed by the Supreme Court of the United States.

A. CALDER MACKAY.

[Endorsed]: Application for Stay of Mandate. Filed Feb. 25, 1932. Paul P. O'Brien, Clerk.

[Title of Court and Couse.]

CERTIFICATE OF CLERK U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing seventy-seven (77) pages in case No. 6388, numbered from and including 1 to and including 77, and the foregoing three hundred and one (301) pages, in case No. 6459, numbered from and including 1 to and including 301 to be a full, true and correct copy of the entire record of each of the above-entitled cases in the said Circuit Court of Appeals, made pursuant to request of counsel for the Murphy Oil Company, a corporation, petitioner and cross-respondent, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 31st day of March, A. D. 1932.

[Seal] PAUL P. O'BRIEN,
Clerk.

IN UNITED STATES CIRCUIT COURT OF APPEALS, NINTH CIRCUIT

[Title omitted]

ORDER SUBSTITUTING PARTY PETITIONER-RESPONDENT—NOV. 3, 1930

Upon consideration of the motion of petitioner in each of above causes, this day filed, and it appearing therefrom that on August 15, 1930, Robert H. Lucas resigned and ceased to be Commissioner of Internal Revenue and that on August 20, 1930, David Burnet, became Commissioner of Internal Revenue and ever since that time has been and now is Commissioner of Internal Revenue, it is ordered that said David Burnet, as Commissioner of Internal Revenue be, and he hereby is, substituted for and in the place and stead of Robert H. Lucas as petitioner and/or respondent in each of above causes, and that each of said causes be revived in the name of David Burnet, as Commissioner of Internal Revenue.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

[Title omitted]

CERTIFICATE OF CLERK U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT TO SUPPLEMENTAL RECORD, CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing page to be a full, true and correct copy of the order substituting party petitioner-respondent entered in this court on November 3, 1930 and constitutes the supplemental transcript of this cause, certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the original thereof remains on file and appears of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City

of San Francisco, in the State of California, this 18th day of May, 1932.

Paul P. O'Brien, Clerk. (Seal United States Circuit Court of Appeals, Ninth Circuit.)

In United States Circuit Court of Appeals for the Ninth Circuit

[Title omitted]

Order Staying Issuance of Mandate—Filed April 28, 1932

Upon application of Mr. A. Calder Mackay, counsel for the petitioner and cross-respondent, and good cause therefor appearing, it is ordered that the issuance, under Rule 32, of the mandate of this Court in the above cause be, and hereby is, stayed to and including May 20, 1932; and in the event the petition for a writ of certiorari to be made by the petitioner and cross-respondent herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

Curtis D. Wilbur, United States Circuit Judge.

Dated San Francisco, California, April 28, 1932.

[File endorsement omitted.]

Supreme Court of the United States

Order Allowing Certiorari—Filed May 31, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

No. [redacted] 80

MAY 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1931.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

RANDOLPH E. PAUL,
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New York City.

THOMAS R. DEMPSEY,
KENYON F. LEE,
Of Counsel.

Pandick Press, Inc., 22 Thames St., New York, U. S. A.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1931.

No. .....

MURPHY OIL COMPANY, a Corporation,
Petitioner,
vs.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Murphy Oil Company, a corporation, respectfully shows to this Honorable Court that this is a petition for a writ of certiorari to the Circuit Court of Appeals, Ninth Circuit, to review a decision made and entered by that Court on January 11, 1932 (R. II-296)*, reversing

* Since the record is a consolidation of the record in two appeals, there is a duplication of page numbers. Therefore the figure I is used where reference is had to the pages of the record in No. 6388 and the figure II is used where reference is had to the pages of the record in No. 6459.

on the issue involved a decision of the United States Board of Tax Appeals (R. I-61). Petitioner filed petition for a rehearing on February 8, 1932, which was denied on February 23, 1932 (R. II-297).

A.

Summary statement of the matter involved.

1. History of case.

This controversy was originated by a deficiency letter issued by the Commissioner of Internal Revenue dated February 6, 1926 (R. I-18), proposing a deficiency in income tax against petitioner for the years 1919 and 1920 amounting to $398,400.53 (R. I-18). Petitioner appealed to the Board of Tax Appeals which, on January 17, 1930, rendered its decision eliminating the deficiency proposed (R. I-62). Although the deficiency was eliminated the decision of the Board was in favor of the petitioner taxpayer on only one of the two issues contested before the Board, referred to herein as the bonus and expense points. The contentions of the taxpayer prevailed as to the bonus point and the contentions of the Commissioner prevailed as to the expense point.

Separate appeals were taken by the Commissioner and the taxpayer to the Circuit Court of Appeals, Ninth Circuit (R. I-62, II-253), and that Court on January 11, 1932, handed down decisions reversing the Board of Tax Appeals on the bonus point, involved in the case of *Murphy Oil Company* v. *David Burnet, Commissioner of Internal Revenue* (R. I-62), and affirming the Board on the expense point, involved in the case of *Commissioner of Internal Revenue* v. *Murphy Oil Company* (R. II-253), thus making

the ultimate decision on both points in favor of the Commissioner (R. II-296). Rehearing has been denied (R. II-297). The records in the two appeals have now been consolidated by the Clerk of the Circuit Court of Appeals. In order to simplify issues and present to this Honorable Court a clear-cut issue on the bonus point the taxpayer is abandoning its contentions on the expense point and is asking for a writ of certiorari only with respect to the bonus point. Therefore, such writ of certiorari is sought solely as to the case of *Murphy Oil Company* v. *David Burnet, Commissioner of Internal Revenue*, Docket No. 6388 (R. I-1).

2. Facts involved in bonus point.

Prior to March 1, 1913, the taxpayer petitioner acquired in fee two parcels of real estate in California, the Coyote and Whittier properties (R. I-47). Oil and gas were found upon the properties and on March 1, 1913, they were both producing. On December 1, 1913, the taxpayer leased the properties to the Standard Oil Company of California for a term of forty years for the purpose of developing and producing oil and gas (R. I-50). The lessor reserved a one-fourth royalty and the lessee agreed to and did pay in installments from 1913 to 1918, inclusive, and "independently of and in addition to royalties", a so-called bonus of $5,500,000.00. The bonus was not dependent upon production (R. I-59). Personal property was transferred in connection with the lease to which has been allocated $326,404.82, leaving a net bonus of $5,173,595.18 (R. I-51). The Commissioner has allocated this bonus between the properties, $4,517,402.70 to the Coyote property and $656,192.48 to the Whittier property (R. I-52).

Since the properties were acquired prior to March 1, 1913, the basis of the taxpayer for computing depletion is

the value on March 1, 1913. That value has been found by the Commissioner to be $15,710,899.52 for the Coyote properties and $1,450,207.08 for the Whittier properties, and is not in dispute (R. II-272).*

Pursuant to Article 215 (a) of Regulations 45 as then in effect (1920 edition) and before amendment by Treasury Decision 3938, C. B. V.—2, p. 117, this bonus was treated in the deficiency letter issued by the Commissioner as a return of capital and the entire bonus was applied in reduction of the value at March 1, 1913, as a basis for depletion (R. I-18). The petitioner appealed to the Board on the ground that the bonus was not a *return of capital* but was *income* (R. I-6). The Commissioner answered and the case was tried by both parties on the assumption that the issue was whether or not the bonus was a return of capital or income. Subsequent to the trial the Commissioner "confessed error" in his brief (R. I-58), changing his position in accordance with the then recently issued amendment of Article 215 (a) of Regulations 45 by Treasury Decision 3938, *supra,* which provided that bonuses were to be treated not as a return of capital but as income and that a certain amount of depletion, according to the formula provided in the amended regulation, should be allocated to the bonus income as received irrespective of when oil was produced from the properties. In its 1920 edition, Article 215 (a) of Regulations 45, before amendment by Treasury Decision 3938, *supra,* provided as follows:

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* The Circuit Court of Appeals deals only with the Coyote property (see "Depletion Schedule", R. II-270), saying (R. II-271):

> "Hereinafter only the depletion of the Coyote property as affected by the portion of the bonus allocated to that property will be considered in detail, but the same principles are also applicable to the depletion of the Whittier property."

> "(a) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

This language was revised by Treasury Decision 3938, *supra,* to read as follows:

> "(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

The contrast between these two editions of Article 215 (a) may be briefly illustrated in their applicability to the instant case. If a bonus is treated as a "return of capital to the lessor" naturally the lessor's capital sum returnable through depletion is reduced *in toto* by the amount of the bonus. This was done in the deficiency letter. On the

other hand, if a bonus is treated as "income" and a deduction for depletion is allowed "in respect of the bonus", as in the amended article, the capital sum remaining at the beginning of taxable years after the bonus has been received has been reduced by whatever amount of depletion has been so allocated to and allowed in respect of the bonus. Thus, the capital sum at the beginning of the taxable year is reduced without a correlative reduction of reserves and the depletion unit per barrel is accordingly reduced. The effect is, of course, to lower the depletion allowance in the taxable year.

For example, if a capital sum returnable through depletion is allowed of $1,000,000 with a mineral reserve of 2,000,000 barrels, the depletion unit is $0.50 per barrel. As production takes place both the mineral reserve and the capital sum returnable through depletion is reduced. If a bonus of $200,000 is received and there is allocated to the bonus depletion of $100,000, the capital sum is reduced to $900,000, without a correlative reduction of the reserves; thus the taxpayer's depletion unit instead of being $0.50 per barrel, is reduced to $0.45 per barrel—$900,000 divided by 2,000,000 barrels.

The Board held that the revised regulation was invalid (R. I-60). It likewise impliedly rejected the principle of the earlier regulation. It sustained the petitioner's method of computing depletion. In reversing the Board of Tax Appeals the Circuit Court of Appeals approved the amended regulation and its principle of offsetting depletion against the bonus on the theory that the bonus was *in part* a return of March 1, 1913, value and *in part* taxable income (R. II-290). Inasmuch as the theory of the amended regulation was raised by the Commissioner in his

brief filed subsequent to the trial, no opportunity has ever been furnished for the submission of the proof necessary to determine the amount of the bonus which should be deducted pursuant to the amended article and under the decision of the Circuit Court of Appeals. The effect of the decision of the Circuit Court of Appeals is to affirm the deficiency originally proposed of $398,400.53. The deficiency, as computable under the formula prescribed in the amended regulation approved by the Circuit Court of Appeals, would undoubtedly be different. The result is an affirmance of the admittedly erroneous deficiency proposed by the Commissioner in his deficiency letter (R. II-291).

3. Question involved.

The bonus point involves the meaning of the word "depletion" as used in Sections 214(a) (10) and 234(a) (9) of the Revenue Act of 1918, which provide:

> "Section 234(a)—That in computing the net income of a corporation subject to the tax imposed by Section 230, there shall be allowed as deductions:
>
> * * *
>
> "(9) in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * *".

(Section 214(a) (10) is identical in language.)

The question involved therefore is whether a bonus paid to the taxpayer for entering on December 1, 1913, into a lease of its oil properties, should be applied in reduction of the depletable base of the taxpayer with respect to the property leased, viz., in the instant case value at March 1, 1913. This question resolves itself into a question whether

depletion, which would be allowable to the taxpayer in the years 1919 and 1920, on a production or exhaustion basis, may be transferred to the prior years in which the bonus was received. Article 215(a), as amended, by Treasury Decision 3938, *supra,* and as approved by the Circuit Court of Appeals, provides that depletion may be transferred or allocated in accordance with income received and the validity of the amended article is therefore brought into issue. The really basic question is whether depletion in a given taxable year is to be determined by reference to the measuring rod of income received or by reference to the exhaustion or depletion of the property in the year—on a dollar or a barrel basis.

B.

Reasons for granting the petition.

(1) In its approval of Article 215(a), as amended by Treasury Decision 3938, *supra,* the opinion of the Circuit Court of Appeals is erroneous and in conflict with the decision of this Honorable Court in the case of *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301, in that Article 215(a), as so amended, proposes by the mechanism of reducing the taxpayer's capital sum returnable through depletion, to transfer depletion properly allowable in 1919 and 1920, when oil was produced, to prior years when income in the form of a bonus was received.

Depletion means actual exhaustion of the depletable property. The statutory allowance for depletion is to be accorded only as actual exhaustion takes place. Article 215(a), as amended, allows a depletion "in respect of the

bonus'' of ''an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received''.

This formula disregards exhaustion of the property altogether as determining the amount of depletion. The result of the application of the formula is to determine the depletion deduction upon an *income* basis. It is established that bonuses are income. In its approval of the amended regulation, the decision of the Circuit Court of Appeals is, in principle, applicable not only to depletion in cases involving a bonus, but to depletion in cases in which no bonus is involved. It is also applicable to other statutory deductions such as depreciation, obsolescence and losses. The decision is, therefore, in conflict (a) with the basic statutory concept that these deductions for any particular year should be determined by what happens to the property in that year and not by the amount of income received in any year, and (b) with the decisions of other Circuit Courts of Appeals, particularly the Eighth Circuit, in *Kansas City Southern Ry. Co.* v. *Commissioner,* 52 F. (2d) 372 (C. C. A. 8th), certiorari denied 284 U. S. Advance Sheets, Part 2, Page VIII. The decision strikes at the heart of the basic concept of several of the statutory deductions and disregards as well the established concept of the taxable year as a unit of time. It is from this radical interpretation of the unambiguous word ''depletion'', as used in the statute, that an appeal is desired. If a decision so upsetting established concepts and practice is not reviewed, great confusion will result in the minds of millions of taxpayers and in the administration of the income tax.

(2) The Circuit Court of Appeals has erroneously construed, and its decision is in conflict with the decision of this Honorable Court in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, in that it reasons from that case that the depletable base of the taxpayer as lessor and the depletable base of the taxpayer's lessee, the Standard Oil Company, cannot exceed the value at March 1, 1913, of the taxpayer's properties. The decision in the *Alworth-Stephens* case, *supra,* did not involve, as does the instant case, a lease made after February 28, 1913. The statute plainly provides that the depletable base of the lessor in such a case shall be the value of its property at March 1, 1913, and that the depletable base of the lessee shall be the cost of its property. There is absolutely no provision for deducting the lessee's cost from the lessor's base, value at March 1, 1913, on account of a lease made *after* that date and the receipt of a bonus in connection therewith.

(3) The Circuit Court of Appeals opinion is contradictory in asserting the validity of Article 215(a), as amended; and in suggesting the division of the value at March 1, 1913, between lessor and lessee, which division it presumes to be required by the *Alworth-Stephens* case, *supra.* Article 215(a) as amended does not purport to reduce the lessor's capital sum returnable through depletion. It simply provides for the distribution of the entire capital sum returnable through depletion over the years in accordance with a formula based upon the receipt of income, as distinguished from exhaustion of the property.

(4) The decision of the Circuit Court of Appeals is in conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Underwood* v. *Commissioner,* 56 F. (2d) 67, with the decision of the Court of Appeals of

the District of Columbia in *Dempster Mill Mfg. Co.* v. *Burnet*, 46 F. (2d) 604, and with the decision of the Circuit Court of Appeals for the Fifth Circuit in *The Alger Sullivan Lumber Company* v. *Commissioner*, 1932, Commerce Clearing House, Standard Federal Tax Service, paragraph 9194 (not yet elsewhere reported), in that the court failed to remand the case tried below upon an assumption presented by the pleadings (the Commissioner's deficiency letter, the taxpayer's petition to the Board of Tax Appeals and the Commissioner's answer thereto) and shared by both parties as to the issue involved, which assumption was departed from by the Commissioner after the trial before the Board.

Both parties shared the view at the trial that the only question for determination was whether the instrument of December 1, 1913, pursuant to which the bonus was paid to the taxpayer, was an agreement of sale or lease. It was asserted by the deficiency letter to be an agreement of sale so that the bonus was a return of capital. The deficiency letter was based upon the then outstanding 1920 edition of Article 215 (a) of Regulations 45. The taxpayer contended that the instrument was a lease and that the entire bonus was income. The position of the Commissioner, taken after the Board hearing, upon the basis of the amended edition of Article 215 (a), was that depletion should be allocated to the years in which the bonus was received, as distinguished from the years in which depletion was sustained. It was this latter position which was approved in principle by the Circuit Court of Appeals.

This disposition of an important case, on grounds not in the minds of the contending parties and reaching a result admittedly erroneous, raises grave problems of practice and procedure involving upwards of seventeen

thousand cases now pending before the Board. These problems should and can be settled only by this finally authoritative tribunal. It is a matter of prime concern to thousands of taxpayers to know whether the burden-of-proof rule, to use the language of the Court in the *Underwood* case, *supra*, goes to the extent of requiring the Board or Courts to "countenance" such an "obvious injustice" as is involved in the decision of the Circuit Court of Appeals in the instant case.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record of all proceedings in the cases numbered and entitled Docket No. 6388, Murphy Oil Company, a Corporation, Petitioner, v. David Burnet, Commissioner of Internal Revenue, Respondent, and Docket No. 6459, David Burnet, Commissioner of Internal Revenue, Petitioner, v. Murphy Oil Company, a Corporation, Respondent, and that the judgment of the Circuit Court of Appeals, Ninth Circuit, in Docket No. 6459 may be reversed by this Honorable Court, and the decision of the Board of the Tax Appeals be reinstated and affirmed, and that your Petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

MURPHY OIL COMPANY,
By RANDOLPH E. PAUL,
Attorney for Petitioner,
170 Broadway,
New York City.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1931.

No. .....

MURPHY OIL COMPANY, a Corporation,
Petitioner,
vs.
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

I.

Opinion Below.

The opinion of the Circuit Court of Appeals, Ninth Circuit, is reported in 55 F. (2d) 17.

II.

Jurisdiction.

The jurisdiction of this Court is involved on the following grounds:

(1) The judgment to be reviewed was originally entered January 11, 1932 (R. II-268). The taxpayer filed a petition for rehearing which was submitted on February 8, 1932, and denied February 23, 1932 (R. II-297). Time to apply for a writ of certiorari, therefore, runs from February 23, 1932. (*Citizens' Bank of Michigan City* v. *Opperman*, 249 U. S. 448, 450; *Morse* v. *United States*, 270 U. S. 151, 153).

(2) The Board of Tax Appeals had jurisdiction of this case under Section 274(a) of the Act of Congress, approved February 26, 1926, entitled the "Revenue Act of 1926" (44 Stat. 55; 26 U. S. C. A., Sec. 1048). The appeals to the Circuit Court of Appeals were taken in pursuance of the provisions of Sections 1001, 1002 and 1003 of the Act of Congress approved February 26, 1926, entitled the "Revenue Act of 1926" (44 Stat. 1, 109, 110; 26 U. S. C. A., Sections 1224, 1225, 1226), as amended by Section 603 of the Act of Congress approved May 29, 1928, entitled the "Revenue Act of 1928" (45 Stat. 873, 26 U. S. C. A., Section 1224).

(3) This Court has jurisdiction to review the judgment of the Circuit Court of Appeals. *Old Colony Trust Company et al., Executors* v. *Commissioner*, 279 U. S. 716.

III.

Question involved.

The question immediately presented by the decision of the Circuit Court of Appeals in the instant case is whether the taxpayer's capital sum for purposes of depletion in the years 1919 and 1920 should be reduced by a bonus received by the taxpayer in previous years for entering on December 1, 1913, into a lease of its oil properties. This question resolves itself into a question whether depletion, which would be allowable to the taxpayer in the years 1919 and 1920 on the production basis, may be transferred to prior years when the bonus was received. The fundamental question is, therefore, whether Article 215(a) of Regulations 45, as amended by Treasury Decision 3938, C. B. V-2, p. 117, is valid and in conformity with the Statute in determining the amount of depletion in any year in which a bonus is received by reference to the income of that year and not by reference to the exhaustion or depletion of the property in that year.

IV.

Assignments of error.

(1) The Circuit Court of Appeals erred in holding that the taxpayer's capital sum for purposes of computing depletion in the years 1919 and 1920 should be reduced by a bonus received in previous years.

(2) The Circuit Court of Appeals erred in holding that any part of the depletion allowance of the taxpayer, com-

putable upon a production or exhaustion basis for the years 1919 and 1920, should be transferred to previous years when the taxpayer received a bonus for entering into a lease of its oil properties.

(3) The Circuit Court of Appeals erred in holding that Article 215(a) of Regulations 45, as amended by Treasury decision 3938, *supra,* is valid and in conformity with the Statute.

(4) The Circuit Court of Appeals erred in holding that the word "depletion", which, as used in the Revenue Act of 1918, means actual exhaustion of properties, may be determined on the basis of income received, as distinguished from exhaustion or reduction of mineral reserves.

(5) The Circuit Court of Appeals erred in holding that in the case of a lease entered into after February 28, 1913, the total depletable interest of the lessor and lessee might not exceed the value of the properties at February 28, 1913, when there was no sale of the properties.

(6) The Circuit Court of Appeals erred in holding that the burden-of-proof rule precluded the remanding of the case for further evidence where the record was complete on the theory of the case and issue stated in the pleadings before the Board of Tax Appeals (deficiency letter, taxpayer's petition, and the Commissioner's answer), but was not complete on a theory of the case advanced by the Commissioner for the first time after the trial thereof. The burden-of-proof rule does not go further than to require the taxpayer to sustain the burden of proof with respect to the issue presented by the pleadings and shared by the litigants at the trial.

V.

Argument.

A.

Depletion means actual exhaustion of the depletable property and (1) should be allowed only as actual exhaustion takes place, and (2) should not be allocated to particular taxable years by means of a formula based upon receipt of income.

The instant case involves a problem of depletion. The statutory provision requiring interpretation is as follows:

> "Section 234(a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * *
>
> "(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * *."

The question involved, simply stated, is whether under this provision (Sec. 234 (a) (9) of the Revenue Act of 1918) a depletion allowance may be made to a lessor of oil properties in respect to a bonus received and without reference to the amount of oil taken from the properties. What is the meaning of the word "depletion" as used in the statute? The word is wholly unambiguous and has been repeatedly defined by this Honorable Court and other authorities.

The noun "depletion" is defined in Webster's New International Dictionary as "Act of depleting; a state of being depleted".

The verb "deplete", according to the same authority, means: "to reduce by destroying or consuming the vital powers of; to exhaust, as a country of its strength or resources, a treasury of money, etc."

In *United States* v. *Ludey*, 274 U. S. 295, 302, this Court, referring to the depletion provision, said:

> "The depletion charge * * * represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment."

Again in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 369, this Court said:

> "In the case of mines, a specific kind of property, the exhaustion is described as depletion, * * *. The interest of respondent under its leases in the mines being property, its right to deduct a reasonable allowance for exhaustion of such property, if there be any, during the taxable year, results from the plain terms of the statute, such deduction, since the property is an interest in mines, to be limited to the amount of the exhaustion of respondent's interest caused by the depletion of the mines during the taxable year We agree with the circuit court of appeals * * * that 'The plain, clear, and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to every one whose property right and interest therein have been depleted by the extraction and disposition "of the product thereof which has been mined and sold during the year for which the return and computation are made". * * *'"

A. R. R. 1147, C. B. I-2, p. 138 and A. R. M. 148, C. B. I-1, p. 186, adhere to the definition of depletion contained in the above authorities. In the latter of the two rulings it is said at p. 187:

> "* * * Where no mineral is produced upon the premises it follows that the interest of the taxpayer in the mineral reserves is not affected and that no allowance can be made for depletion."

Under the accepted definition of the word "depletion" the *sine qua non* of any allowance is the exhaustion of taxpayer's reserves. If there is no exhaustion, there can be no depletion and there is no authority for an allowance therefor. The depletion of the taxpayer's properties in the instant case was not a condition to the payment of the bonus. The bonus was paid without reference to the exhaustion of the taxpayer's properties and it is against the plain meaning of the statutory provision and the authorities defining depletion to allow depletion in respect of a bonus which has no reference whatever to production. This was distinctly recognized by the Board and forms the basis of its decision, as indicated by the following quotation from its opinion (15 B. T. A. 1195, at 1203) (R. I-59):

> "The bonus payment in the instant case was a part of the consideration paid for the lease. While expected production undoubtedly was considered in fixing the amount of the bonus, it is elementary under the laws governing such agreements that its payment did not, in anywise, depend upon, or relate to, production. The lessee's liability therefore was fixed by the terms of the contract. On the other hand, the operation of the principle of depletion depends upon exhaustion of resources through production—i.e., the recovery of capital through its con-

> version from the form of oil resources or reserves into marketable products or the equivalent received for such product. Under such principle the depletion allowance for the year or years of the bonus payments can only be measured by reference to the oil produced. If, as we have pointed out, the bonus is income, no part of which represents recovery of capital, it follows that any depletion allowance against such income is a departure from the depletion concept. The regulation relied on by the respondent is clearly such a departure."

The opinion of the Circuit Court of Appeals in the instant case is not altogether easy to follow, but the effect is to approve the regulation of the Commissioner allocating depletion to a bonus received in connection with an oil lease. This is indicated by the following quotation from page 25 (R. II-290):

> "The regulation is not only not in conflict with the statute, but directly conforms thereto."

The reference to the regulation so held to conform to the statute is to Regulations 45, Article 215(a), as amended on November 13, 1926, by Treasury Decision 3938, *supra*. As so amended, the regulation provides (italics ours):

> "(a) Where a lessor receives a bonus in addition to royalties, *there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received.* Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

Before amendment Article 215(a) in its 1920 edition provided (italics ours):

> "(a) Where a lessor receives a bonus or other sum in addition to royalties, *such bonus or other sum shall be regarded as a return of capital to the lessor,* but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

This regulation, as amended on November 13, 1926, represents the second change of mind and third attempt of the Commissioner to deal with this subject. Originally, prior to the promulgation of the 1920 edition of Regulations 45, the Commissioner ruled that bonuses were income. When he promulgated Article 215(a) of Regulations 45, 1920 edition, the Commissioner changed his mind and ruled that a bonus "shall be regarded as a *return of capital* to the lessor". On November 13, 1926, the Commisisoner again changed his mind, and ruled in Treasury decision 3938, *supra,* amending Article 215(a) of Regulations 45, that a bonus was *income;* but in this regulation the Commissioner added to his conception of a bonus as income an entirely new conception—that a depletion deduction should be allowed "in respect of the bonus" equal to the "proportion of the cost or value of the property on the basic date which the

amount of the bonus bears to the sum of the bonus and royalties expected to be received."

The expression "royalties expected to be received" deserves some parenthetical comment. It may be possible under certain mineral leases to determine with reasonable accuracy on a dollar basis the royalties to be expected over the life of the property or the term of the lease. But the lease involved in the instant case is an oil lease and any estimation of royalties to be expected involves the determination of highly problematical factors such as future price of oil over a long period—in the instant case forty years. This Honorable Court will recognize the highly speculative character of any estimate or prophecy of the amount of royalties to be expected by this taxpayer; to express the amount in dollars involves almost insuperable difficulties of proof; indeed, it is extremely doubtful whether future royalties are susceptible of proof. See *Burnet* v. *Logan*, 283 U. S. 409, 412. This would indicate that the regulation, as amended, is so arbitrary and capricious that it is beyond the scope of the Commissioner's power which is limited to authority to make reasonable regulations. However, the fundamental question is: *Must depletion be computed and allowed on the basis of income received, or on the basis of the actual exhaustion of the properties?*

It is not specifically said, but it is, of course, implied in the amended regulation that a bonus is income. That it is income is absolutely settled.* What causes the difficulty in

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* *Alexander* v. *King*, 46 F. (2d) 235 (C. C. A. 10th), reversing 38 F. (2d) 256; *Berg, et ux.* v. *Commissioner*, 33 F. (2d) 641 (Ct. of App. D. C.), affirming (6 B. T. A. 1287), *certiorari* denied, 280 U. S. 598; *Burkett* v. *Commissioner*, 31 F. (2d) 667 (C. C. A. 8th), affirming 7 B. T. A. 560, *certiorari* denied, 280 U. S. 565; See also *Weiss* v. *Wiener*, 279 U. S. 333, reversing 27 F. (2d) 200 (C. C. A.

the instant case is not the question whether a bonus is income, but whether a depletion deduction shall be allowed in respect of the bonus (the payment of which in the instant case was not dependent upon production) and without reference to the exhaustion of the depletable property. In other words, the whole issue is whether depletion shall be deducted as and when a bonus is received and wholly independently of production from or exhaustion of the property—or as and when the mineral reserves are taken from the property, and converted into marketable products. The real question is whether depletion is to be allocated to years when income is received, or to the years when the property suffers depletion.

It does not require any elaborate discussion to point out the far-reaching effects of a decision that depletion is to be deducted, as the Circuit Court of Appeals has decided, not as it occurs, but as income is received from the depletable property. The uniform practice of the Commissioner has been to calculate depletion for each annual period, not on a *dollar* basis, according to the income from the property, but on a *barrel* basis, according to the amount of mineral taken from the property. It is only when bonuses are received in connection with *mineral* leases that the Commissioner indulges in the strange departure from his usual practice, and from the concept of the statute.

If depletion is to be allocated in accordance with income, there is absolutely no reason for differentiating between

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6th), reversing 17 F. (2d) 650; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503, reversing 219 Fed. 31 (C. C. A. 8th); *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103; *Stratton's Independence, Ltd.* v. *Howbert*, 231 U. S. 399, affirming 207 Fed. 419; *Rosenberger* v. *McCaughn*, 25 F. (2d) 699 (C. C. A. 3rd), *certiorari* denied, 278 U. S. 604; *New Creek Co.* v. *Lederer*, 295 Fed. 433.

leases involving bonuses and those which do not. A bonus does not differ from ordinary royalties in being income; both are income; the bonus in the instant case differs from the ordinary royalty only in that it was payable whether or not there was any production from the property and whether or not the lessee entered upon the property. The allocation of depletion to a bonus by the formula provided in Article 215(a), as amended, amounts to the allocation of depletion in accordance with income and not in accordance with the exhaustion of the reserves in the depletable property. The generic vice of the amended regulation is in using income as a measuring rod of annual depletion instead of the exhaustion of the property. The receipt of income does not vary year by year solely in accordance with the exhaustion of the property; other factors intervene, such as the price of oil and the cost of extracting the oil.

Since bonuses and ordinary royalties are both income the method used in Article 215(a), as amended, is, in principle, equally applicable, if sound, to all depletion. That being so, depletion should be measured by dollars (income basis) rather than by barrels (exhaustion basis) regardless of whether a bonus is involved.

If depletion should be computed on the dollar basis, depreciation, which is essentially the equivalent of depletion,* should also be computed on a dollar basis according to income and not according to exhaustion of the property. It follows from this radical doctrine that every depletion and every depreciation allowance ever computed by the Commissioner is wrong. He should recompute all depletion and depreciation allowances, spreading them over the

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* In *United States* v. *Ludey*, 274 U. S. 295, 303, this Honorable Court has said: "In essence, the deduction for depletion does not differ from the deductions for depreciation."

years in proportion to the income received each year. In this fundamental sense Article 215 (a), as amended, is a revolutionary departure from the concept of the statute and from the otherwise unvaried practice of the Commissioner.

What has been said with respect to depreciation applies equally to obsolescence and losses—all the deductions which are allowed to the taxpayer as a compensation for the exhaustion of property used in the production of income.

It was attempted by the taxpayer in *Kansas City Southern Railway Company* v. *Commissioner,* 52 F. (2d) 372 (C. C. A. 8th), certiorari denied 284 U. S. Advance Sheets, Part 2, Page VIII, to secure a deduction in 1918 and 1919 for obsolescence of a building which, as the Court observes, "occurred prior to 1913". The Circuit Court of Appeals for the Eighth Circuit showed throughout its opinion its clear understanding of the statutory concept of depreciation and obsolescence. The concept is that income must be taxed on an annual basis and that the deductions are permissible only on account of something happening in the year, something apart from the mere receipt of income. The Court said at page 376:

> "The rule as to allowance for exhaustion, wear, and tear of property used in the trade or business is the same as the rule concerning obsolescence. We think no case can be found holding that exhaustion, wear, and tear of former years may be carried over and deducted in arriving at the income in some subsequent year. A loss attributable to a particular year is a loss occurring by reason of something happening in that year. It is not given to parties to make choice as to the years in which they will take reductions."

In the case of depreciation there must be, under the doctrine of the *Kansas City Southern* case, a diminishment of the properties, an exhaustion of that which produces the income. This decision of the Circuit Court of Appeals for the Eighth Circuit is simply irreconcilable with the decision of the Ninth Circuit in the instant case.

This Honorable Court has passed only once on the question of precisely how depletion shall be computed. The Board of Tax Appeals stated the rule with absolute clearness in *Thompson Oil & Gas Co.*, 15 B. T. A. 993, affirmed by this Court in 283 U. S. 301. The Board said at page 997, (italics ours):

> "That a reasonable allowance for the depletion of a wasting or exhaustible asset, such as we have here, will be obtained by considering that the recoverable value will *become exhausted in the same ratio as that which gives value to the asset disappears,* can hardly be questioned. *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364. For example, if at January 1, 1917, a taxpayer had purchased a leasehold for the recovery of oil at a cost of $100,000 with oil to be recovered of 400,000 barrels, and if, during 1918, 100,000 barrels had been produced, a depletion allowance of $25,000, or 25 cents per barrel would certainly be accepted as the reasonable depletion allowance for 1918."

This Court, in affirming this decision, stated that the question involved was whether in determining depletion under the 1918 Act there should be deducted from the capital sum, *viz.*, the capital value recoverable through depletion, depletion actually sustained in earlier years or only so much of that depletion as was allowable as a deduction under revenue acts in force in earlier years. The de-

duction *permitted* for earlier years fell about $85,000 short of the *sustained* depletion—the amount by which the reserve was exhausted. The taxpayer argued that only the depletion *allowed* should be used to reduce the capital sum. The Commissioner argued that the entire amount *sustained* should reduce the capital recoverable.

Analyzing the contention of the taxpayer, this Court held that it was in effect trying to make up in 1918 for the depletion sustained but not allowed in earlier years as a deduction—that it was attempting in 1918 to obtain a deduction for depletion not *sustained* in 1918. The court held emphatically that only the sustained depletion of 1918 was allowable, saying at page 306:

> "The tax is an income tax for 1918, and in the absence of express provision to the contrary, it is not to be supposed that the taxpayer is authorized to deduct from that year's income, depreciation, depletion, business losses or other similar items attributable to other years. * * * The construction adopted by the court below in effect results in including in the taxable year items referrable to other years, and is contrary to the theory of a tax for specific years.
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> "The nature of the tax as one for annual periods has been repeatedly mentioned in dealing with its application in various situations. The taxable year 1918, and that only, is involved, and deductions applicable to that year only should be allowed."

This Court, in thus refusing the taxpayer in the *Thompson* case the deduction of depletion not sustained in the taxable year, announced a principle which is conclusive of the real issue in the instant case. Depletion should be taken and measured by that sustained.

The Revenue Act of 1918 grants in Section 234 (a) (9) a reasonable allowance for depletion. It is true that the allowance of depletion is a matter of legislative grace.* Congress might grant any allowance it pleased or none at all. But once Congress has legislated, giving a deduction in unambiguous terms by the use of the word "depletion," there can be no excuse for departing from the conception of the statute. The fact that the allowance of depletion is a matter of legislative discretion does not mean that the Commissioner, in interpreting the statute, may exercise a discretion which contravenes the statute. Nothing can be substituted for the will of Congress as clearly expressed. The word "depletion" is unambiguous. It stands for a fact, an exhaustion which happens to the property in the taxable year. If then no depletion happens in the year, no depletion can under the statute be allowed; if it does happen, depletion cannot legally be shifted to other years. It is a perversion of the statute and a denial of the will of Congress to allow or deny depletion according to the wholly irrelevant existence or nonexistence in a year of a bonus, or any other type of income.

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* *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, reversing 40 F. (2d) 493 (C. C. A. 10th), which reversed 15 B. T. A. 993; *United States* v. *Biwabik Mining Co.*, 247 U. S. 116; *Stratton's Independence, Ltd.* v. *Howbert*, 231 U. S. 399, affirming 207 Fed. 419; *Pugh, et al.* v. *Commissioner*, 49 F. (2d) 76 (C. C. A. 5th); *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837 (C. C. A. 2nd), *certiorari* denied, 282 U. S. 897.

B.

The decision of the Circuit Court of Appeals misapplies the decision of this Honorable Court in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364.

The opinion of the Circuit Court of Appeals is so difficult to follow that it may clarify the real issue involved to refer to some further errors which may contribute to the utimate error of that Court.

The opinion discusses the bonus question both on principle and on authority (R. II-272-276). The conclusion reached "on principle" is to the effect that the fee valuation of $15,710,899.52 represented the total combined interest at March 1, 1913, of the taxpayer, as lessor, and of the lessee, and that no greater sum should be depleted (R. II-272). It is said that: "The allowance of the total depletion to the lessor, as was required by the decision of the Board of Tax Appeals, left nothing to be apportioned to the interest of the lessee in the property" (R. II-282). In support of this conclusion Section 234 (a) (9) of the 1918 Act, and also Section 214 (a) (10) of that Act, are referred to, particularly the last sentence, to the effect that the depletion deduction "shall be equitably apportioned between the lessor and lessee" (R. II-282).

To interpret the apportionment clause the Circuit Court of Appeals refers to the case of *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364 (R. II-281), placing particular emphasis on that part of the opinion of this Court, wherein it was stated:

> "* * * There is an exhaustion of property in the one case as in the other; and the extent of it, *with the consequent deduction to be made, in each case is*

> *to be arrived at in the same way, namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based upon the market value of the product, and allocating that amount in proportion to the interest of each severally considered.* Pages 369, 370 of 267 U. S., 45 S. Ct. 274, 275, 69 L. Ed. 660. (Italics ours)"

The decision that not more than $15,547,522.17* should be depleted after November 30, 1913, by lessor and lessee cannot be reconciled with the later conclusion of the opinion that Article 215 (a) of Regulations 45, as amended, is valid (R. II-290). That regulation, to put it simply, permits depletion *to the lessor* with respect to the *entire* March 1, 1913, value. It rules that the value at March 1, 1913, allowable in full as depletion to the lessor, should be applied in part against the bonus by providing that the lessor shall be entitled to deduct "that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and royalties expected to be received". Article 215 (a) simply deals, and makes no attempt to do anything more than deal, with the *distribution of depletion* over the years.

Since the lessee is by the statute and the regulations permitted depletion of the cost where the lease is entered into subsquent to February 28, 1913, the depletion in the instant case under the regulations, approved by the Circuit Court of Appeals, must equal $15,710,899.52 allowed to the lessor and $4,517,402.70 allowed the lessee, or a total of $20,228,302.22.

Thus, the conclusion of the Circuit Court of Appeals that Article 215 (a), as amended, conforms to the statute

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* This is the value at March 1, 1913, $15,710,899.52 (Coyote property), depleted to December 1, 1913, the date of the lease. See footnote, page 4.

is wholly inconsistent with its reasoning that not more than the total basic value at March 1, 1913, should be deducted by lessor and lessee.

As has been pointed out, the Circuit Court of Appeals refers to the so-called "apportionment" clause of the depletion provision in support of its conclusion that not more than $15,547,522.17 may be depleted after November 30, 1913. The clause provides that "in the cases of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *." The opinion of the Circuit Court of Appeals at pages 20-21 of 55 Federal Reporter, Second Series, (R. II-276) shows the basic misapprehension under which it was laboring when it says that land worth $15,547,522.17 could not be sold for more subject to the lease than $11,030,119.47 (the value at December 1, 1913, less the bonus) "which represented his (the taxpayer's) capital investment in the recoverable royalty oil. It would seem then that the interest of the landlord in the royalty oil at the surface would be his proportion of the recoverable content of 10,190,814 barrels at a price to equal $11,030,119.47, which would be $1.08236 per barrel" (R. II-276).

This quotation indicates an opinion that the bonus was entirely a return of capital, which was the issue tried before the Board and which was raised by the deficiency letter, the petition and the Commissioner's answer thereto. Later in its opinion the Circuit Court of Appeals holds that the bonus is *in part* income and *in part* a return of capital (R. II-290). These inconsistent views reflect a failure to distinguish between a return of capital in the *ordinary* sense and a return of capital in the *statutory* sense. Any property subject to a lease might be worth less than the same property clear of a lease; the lease involves a surrender of an interest in

the property less than the whole interest. But such a surrender does not make the rentals or royalties under the lease any the less income, or in any sense reduce the basis or amount which the taxpayer may deduct by way of depletion or depreciation on account of the ownership of the property. The only way in which that statutory basis can be reduced is to sever from the taxpayer the title to part of the property, to transfer all or part of the basic underlying interest. Since depletion is a matter of legislative discretion,* a return of capital in the statutory sense has nothing to do with the return of capital in the ordinary sense. The only way in which the statute calls for a return of capital under these circumstances is through gradual exhaustion of the property. Such return is accomplished through the statutory allowance for depletion based on the actual annual exhaustion of the properties.

The last quotation from the opinion of the Circuit Court of Appeals to the effect that land worth $15,547,542.17 could not be sold for more subject to the lease than $11,030,119.47 is unobjectionable as a statement of fact, if it is meant that the taxpayer's residual or underlying interest might not be saleable for more than the lower figure. Of course, this assumption is unwarranted, for there is no reason why the property may not have appreciated in value between March 1, 1913, and December 1, 1913, when the lease was made. However, whether the property appreciated or depreciated in value, the execution of a lease does not affect the statutory basis for depletion or depreciation. If the owner of a city office building having a depreciable base of $1,000,000 should lease the building for a term of years, receiving on the execution of the lease a bonus of $500,000.00, the owner

* See cases cited in footnote 1, page 28.

would not be required nor permitted to reduce his depreciable base. His depreciable base would remain stationary. The $500,000 bonus would be income of the year of receipt or accrual and the only offset would be the statutory allowance for depreciation, which would be measured by the wear and tear of the building during the year. Of course, the fee owner's interest in the building might not be saleable for as much subject to a lease as clear of a lease, but that does not affect in the slightest degree the basis provided by the statute which may be returned over the life of the property free from tax. There is no way by which that base may be reduced short of a sale of the property or by actual wear and tear which is compensated for by the depreciation allowance.

It is respectfully urged that the decision of the Circuit Court of Appeals, based so largely on the decision of this Court in the *Alworth-Stephens* case, reflects an incorrect application of the true meaning of that decision. It is unnecessary to review to this Honorable Court the situation presented by the *Alworth-Stephens* case. The question presented was whether lessees were entitled under the 1918 Act to depletion based upon value at March 1, 1913. It was held that where the lease was entered into *prior* to March 1, 1913, and *was in effect on that date* the total interest therein was to be divided between the lessor and lessee and that the value at March 1, 1913, of the lessee's interest therein was depletable. As this Court well knows, its theory was that although the lessee might not have acquired the minerals in place, his privilege was a property right at March 1, 1913, the value of which should be returned to the lessee by the depletion allowance or otherwise.

The language of this Honorable Court in the *Alworth-Stephens* case, italicized in the Circuit Court of Appeals' opinion in the instant case, should of course be interpreted in the light of the problem before the Court and the decision and the significance of the italicized words should be limited to cases dealing with *the apportionment of March 1, 1913, value* between a lessor and a lessee when the lease was entered into *prior to and existed on that date.* There is no question in the instant case as to apportionment of value at March 1, 1913, between lessor and lessee because there were not at that date a lessor and lessee. There was simply a fee owner, the taxpayer. The lease involved in the *Alworth-Stephens* case was dated long before March 1, 1913. The facts of the *Alworth-Stephens* case do not support a conclusion that the capital sum of a fee owner returnable through depletion should be reduced in cases in which a fee owner leased property *subsequent* to February 28, 1913.

The statute prescribes "cost" as a general basis for depletion in the first part of subdivision (9) of Section 234(a). This provision gives the basis for the lessee's depletion. The first proviso has nothing to do with the lessee in the instant case because its property was not "acquired prior to March 1, 1913". This proviso does, however, apply to the taxpayer because it had acquired its properties in 1904. The proviso plainly establishes as the basis of the taxpayer's depletion *in lieu of the cost* in 1904, or up to March 1, 1913, "the fair market value of the property (the taxpayer's interest therein)" on March 1, 1913, which is conceded to be $15,710,899.52.* "The taxpayer's interest therein" was the *entire* interest in the property at that date. There was no

* For the Coyote properties only. See footnote 1, page 4.

interest in any other person. The lessee did not acquire its interest until several months later.

There were not two or more interests at March 1, 1913, among which the value at that date could be apportioned. There is nothing in the statute from which it can even be implied that the value of a taxpayer's interest at March 1, 1913, should be reduced because the taxpayer *subsequently* leases property and the lessee acquires a basis by reason of his payment.

The results of such a doctrine would be astonishing. Taxpayers owning property on March 1, 1913, should reduce the basis or capital sum returnable through depletion or depreciation in all cases in which any lease or license is given after that date, whether or not a bonus is received. It is respectfully submitted that in no case should the basis for depletion or depreciation be reduced on account of the receipt of *income*; the reduction is justified only when *capital* is returned. In the absence of sale capital is not returned except as the statute provides. The statute provides that it shall be considered as returned under the depletion allowance when the depletion is sustained.

The *Alworth-Stephens* case, *supra,* holds that the value at March 1, 1913, should be apportioned between the interests in the property *existing on that date,* even though the lessee of an oil and gas lease may have nothing more than a privilege of extraction. The so-called apportionment clause at the end of subdivision (9) of Section 234(a) merely apportions the "deductions allowed by this paragraph," which means that the deduction of value at March 1, 1913, should be apportioned between the interests existing on that date, and not that the value of the taxpayer's interest on that date, which affords the basis for its deple-

tion deduction, should be reduced or modified on account of the subsequent receipt of income from the property.

C.

The burden-of-proof rule does not extend to the point of requiring the taxpayer to submit evidence upon issues not raised by the Commissioner or involved in the theory of the case shared at the trial by the taxpayer and the Commissioner.

It is believed that a *writ of certiorari* should be granted because the instant case raises grave problems of Board of Tax Appeals practice, affecting millions of taxpayers in the important and often critical matter of tax liability.

On the bonus question the Commissioner, in effect, has been sustained by the Circuit Court of Appeals because of the burden-of-proof rule. *Yet the Commissioner is admittedly allowing erroneous depletion* by deducting the *whole* of the bonus from the capital sum returnable through depletion (R. II-291).

In other words, the tax liability established by the Circuit Court of Appeals decision is admittedly erroneous.

The bonus question was tried before the Board on the issue whether the instrument in connection with which the bonus was paid resulted in a *sale* or a *lease*. This was a true issue, for if the instrument resulted in a *sale*, the Commissioner had correctly reduced the depletable capital sum by the amount of the bonus. That was the issue raised by the Commissioner in his deficiency letter (R. I-18). The taxpayer's petition was an appeal *from that letter* (R. I-6). The letter and the petition and the Commissioner's answer to the petition framed the issue before the Board. The proof was put in on the issue so framed. Months after the

evidence was closed the Commissioner "*confessed error*" in his brief in failing to follow the recently revised edition of Article 215(a) of Regulations 45, and urged the contention that the bonus was only *in part* a return of capital and that depletion should be allocated according to income. The Board of Tax Appeals held that no part of such bonus income was a return of capital so that a taxpayer could under the statute take an allowance for depletion to compensate for a loss of capital. The Circuit Court of Appeals has now reversed the Board without remanding the case for further evidence, which it had the power and was urged to do. The evidence on the bonus question was, therefore, presented on a theory shared by both litigants different from that which afforded the basis of the decision of the Circuit Court of Appeals.

It should be kept distinctly in mind that the taxpayer is not contesting the burden-of-proof rule. It does not need to contest that rule. The taxpayer met the burden of proof before the Board. It completely sustained the burden of proof on the issues as framed by the pleadings. The findings of fact of the Board show (R. I-50) the lease on the Coyote property, the receipt, pursuant to the lease and in addition to the royalties received in oil, of the sum of $5,500,000 in instalments beginning December 31, 1913, and extending to December 1, 1918. The bonus did not "in any wise, depend upon, or relate to production" (R. I-59). Thus, the taxpayer proved all that it was necessary to prove under the issues joined and the Board's decision.

The taxpayer is merely contending that the burden-of-proof rule does not extend beyond the scope of the theory upon which the deficiency is asserted and does not require any introduction of evidence by taxpayers of facts ex-

traneous to the issues as framed by the pleadings. This theory has been recognized by the Board of Tax Appeals in its rules of practice.

Rule 30 provides as follows:

> "The burden of proof shall be upon the petitioner, except as otherwise provided by statute and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent."

Rule 14 provides as follows:

> "The answer shall be so drawn as fully and completely to advise the petitioner and the Board of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts on which the Commissioner relies for defense or for affirmative relief * * *".

The care with which the rules of the Board are drawn so as to prevent surprise at the trial is again illustrated by Rule 18, which provides restrictions upon the filing of amended petitions and gives the Board discretion "at any time before the conclusion of the hearing" to permit a party to amend the pleadings to conform to the proof.

The position of the taxpayer is that the Commissioner's answer did not state the facts upon which the Commissioner relied for defense; that the answer of the Commissioner did not "fully and completely" advise the petitioner of the nature of the defense; that the Commissioner did not even at any time amend his pleadings to conform to the proof, and that the remedy in a case in which the issues are completely changed after the trial of the case is not to give judgment to the Commissioner because the tax-

payer had failed to sustain the burden of proof, but to give an opportunity for further proof in conformity with the reframed issues. In no other way can the Board of Tax Appeals perform its true function which is correctly to determine the amount of the deficiency.

This confusion of theories and issues is a stronger case than was presented in *Underwood* v. *Commissioner*, 56 F. (2d) 67 (C. C. A., 4th) for the taking of further evidence. In that case the parties tried the case on a theory shared by both of them that a certain issue was controlling. In the opinion of the Circuit Court of Appeals that issue was immaterial and the record was deficient in its evidence upon the real issue. The Circuit Court of Appeals for the Fourth Circuit did not give judgment to the Commissioner because the taxpayer had failed to sustain the burden of proof, as the Circuit Court of Appeals for the Ninth Circuit has done in the instant case; it carefully limited the burden-of-proof rule and remanded for further evidence, saying at page 72:

> "The case was tried below upon the assumption, in which both parties shared, that the only question for determination was whether the taxpayer was a state employee or an independent contractor. But this was not correct unless that question should be decided adversely to the Commissioner and he should be directed to exclude from the taxpayer's income the entire sums he received from the State of North Carolina. On the other hand, if it should be decided that the income from the State was taxable, it was still necessary to determine the deductions for ordinary and necessary expenses of the business to be allowed under the Revenue Act of 1924, §214, 43 Stat. 269 (26 U. S. C. A. §955 and note).
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"Notwithstanding this state of affairs, the Commissioner failed to make any allowance for the taxpayer's expenses and assessed the tax on the gross receipts; and this action was affirmed by the Board. The only explanation offered in this court is that the evidence before the Board did not disclose the amount of the expenses incurred; that the burden of proof in a case of this sort is upon the taxpayer and therefore, the Board was obliged to affirm the Commissioner's determination. It is settled that the taxpayer has the burden of proof by a number of decisions of the Supreme Court. *Burnet* v. *Houston,* 283 U. S. 223, 51 S. Ct. 413, 75 L. Ed. 991; *Botany Mills* v. *U. S.,* 278 U. S. 282, 49 S. Ct. 129, 73 L. Ed. 379; *Reinecke* v. *Spaulding,* 280 U. S. 227, 50 S. Ct. 96, 74 L. Ed. 385; *Niles Bement Pond Co.* v. *U. S.,* 281 U. S. 357, 361, 50 S. Ct. 251, 74 L. Ed. 901. But we do not think that this rule so restricts the powers of the Board as to require it to countenance an obvious injustice. 'The Board of Tax Appeals is not a court. It is an executive or administrative board.' *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716, 725, 49 S. Ct. 499, 502, 73 L. Ed. 918.

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"The Board had ample power under the statute to require the production of additional evidence when it became clear that it could not do justice to the taxpayer by reason of the deficiencies in the record before it. It was unquestionably incumbent upon the taxpayer to offer the testimony in the first instance, and cases arise where the moving party must suffer the consequences of his own neglect. Here, however, the Board's own opinion showed that the Commissioner's action was wrong in a material respect. The information to correct the mistake was readily obtainable from the same source as that from which the gross receipts of the taxpayer were ascertained.

> Under these circumstances, the Board should have deferred its decision until testimony showing the amount of the deductions to which the taxpayer was entitled was introduced, and then have redetermined the deficiency. The decision of the Board will therefore be reversed and the case remanded in order that the course indicated may be followed."

A case very similar to the instant case is that of the *Alger Sullivan Lumber Co.* v. *Commissioner,* 1932 Commerce Clearing House, Standard Federal Tax Service, paragraph 9194 (C. C. A., 5th)*. The deficiency letter stated that the stock issued to the employees of the taxpayer company was not a bonus; instead the transaction was declared to be a sale to the employees. The issue of whether it was a sale or a bonus was tried before the Board of Tax Appeals. The Board decided that the transaction was a sale (20 B. T. A. 1109). On appeal the Commissioner for the first time raised the question of whether the employees' compensation was reasonable if the stock had been given to them as a bonus. There was no evidence in the record on the question of reasonableness. The Circuit Court of Appeals refused to render judgment for the Commissioner on the ground of failure of proof. It said at page 8588 of the Commerce Clearing House Report:

> "However, it is apparent that the point was not deemed to be material by either petitioner or respondent in the proceedings before the Board and the Board did not consider it. In this situation it would be just and fair to both sides that evidence be admitted on this point and a decision be had upon the question by the Board."

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* Not yet elsewhere reported.

In still another case decided by the Court of Appeals of the District of Columbia (*Dempster Mill Mfg. Co.* v. *Burnet*, 46 F. (2d) 604) a new trial was ordered in the interests of reaching "substantial justice" where the evidence disclosed that the taxpayer had rights but did not fully disclose the extent of those rights. The Board in that case, disregarding the uncontroverted evidence of an interested witness, decided that certain property was without value on March 1, 1913. The Circuit Court of Appeals for the District of Columbia thought there was evidence of value but could not determine the exact value. It therefore said, at page 606:

> "* * * we are of the opinion that substantial justice in this case demands a new trial where the parties can be given an opportunity to adduce such testimony as they may have to offer pertaining to the real issues involved."

Upwards of 17,000 cases are now pending before the Board of Tax Appeals. Many of them have several issues pending. Proof must be submitted on all these issues. The presentation of proof is often a difficult and expensive matter for taxpayers. Justice would seem to require that taxpayers should be protected when they present proof on the issues as framed by the pleadings. All tribunals function most efficiently on this basis; if anything, the practice of the Board, which is not a court, should be more liberal than the practise of the courts. It is one thing to hold that the burden-of-proof rule requires that the taxpayer sustain the burden in proving the issues framed by the pleadings; it is a long step further to require that it submit evidence on all imaginable issues not disclosed in the deficiency letter and answer of the Commissioner to the

petition. This is particularly true where the remedy of taking further evidence is so readily available.

In the state of confusion that exists the simple truth is that this Honorable Court should make some definition, for the information of taxpayers, of the burden-of-proof rule. The propriety of the rule is not being contested on this application; it is being suggested merely that the rule can be carried to utterly unreasonable lengths; it can be made to do more harm than good; it can frustrate, instead of advancing, justice. It is an important matter to taxpayers to know what its limitations are. Where Circuit Courts of Appeals differ it is respectfully urged that this Court should give both government and taxpayers the benefit of its views.

Conclusion.

The essence of the taxpayer's case is simple. It has been shown that a deduction for depletion should be taken only in the years in which depletion is sustained. This is the only true concept of depletion and the only true interpretation of the Revenue Act of 1918. It has also been shown that the bonus payments, which were not dependent upon production, may not be offset by depletion, particularly where the depletion occurs years after the receipt of the payments. It has further been shown that there is no support in the law for the Commissioner's position, and that his amended regulation, approved by the Circuit Court of Appeals, is entirely unjustifiable. The regulation is merely an attempt to legislate and a usurpation of the functions of Congress.

At the beginning of the taxable years involved, 1919 and 1920, the taxpayer had whatever mineral reserve it had

on the basic date, less the amount of minerals actually extracted. Its depletable base, returnable through depletion, was not in fact or in law depleted, lessened, or exhausted by the receipt of the bonus payments. These bonus payments, as the Board held, were by the very terms of the lease made payable unconditionally. They were not in any wise dependent upon extraction or production. It cannot be logically or correctly said that the taxpayer's depletable base was reduced by the receipt of the bonus payments.

Reduced to its real outlines, the regulation in question, Article 215(a), as amended, violates the theory of the statute which gives a depletion allowance on account of "the reduction of the mineral contents of the reserve". All other arguments are extraneous. Arguments as to what should be are irrelevant. The point is: What did Congress provide? This Honorable Court has answered this question. (*Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301). Congress provided in no uncertain terms that depletion should be allowed as a deduction *when sustained.*

It is respectfully urged that this petition should be granted in order that this Honorable Court may affirm the decision of the Board of Tax Appeals herein, and reverse the decision of the Circuit Court of Appeals.

Respectfully submitted,

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No. 80.

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CHARLES ELMORE CR

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

BRIEF FOR PETITIONER.

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IN THE

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OCTOBER TERM, 1932.

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Petitioner,

vs.

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Internal Revenue,
Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

BRIEF FOR PETITIONER.

I.

Opinions.

The opinion of the Board of Tax Appeals (R. II-231-247)* is reported in 15 B. T. A. 1195.

* Since the record is a consolidation of the record in two appeals, there is a duplication of page numbers. Therefore the figure I is used where reference is had to the pages of the record in No. 6388 and the figure II is used where reference is had to the pages of the record in No. 6459.

The opinion of the United States Circuit Court of Appeals, Ninth Circuit (R. II-268-295), is reported in 55 F. (2d) 17.

II.

Jurisdiction.

The statutory provision which is believed to sustain the jurisdiction of this Court is Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, Title 28, U. S. C. A., §347. The judgment of the Circuit Court of Appeals was entered on January 11, 1932 (R. II-297). The date on which the application for the appeal was presented was May 16, 1932. This case is on certiorari from the Circuit Court of Appeals for the Ninth Circuit. Since Section 240 (a) of the Judicial Code as amended makes it competent for the Supreme Court of the United States to review by certiorari any case in a circuit court of appeals, certiorari having been granted, the jurisdiction is established.

The following cases sustain the jurisdiction in that they show that the appellate jurisdiction of the Supreme Court of the United States applies to cases originating in the United States Board of Tax Appeals, and that specifically Section 240 (a) of the Judicial Code applies to such cases. *Old Colony Trust Company, et al., Executors* vs. *Commissioner,* 279 U. S. 716; *Lucas* vs. *American Code Company, Inc.,* 280 U. S. 445.

III.

Statement of the Case.

(1)

History of Case.

This controversy was originated by a deficiency letter issued by the Commissioner of Internal Revenue (referred to herein as the Commissioner) dated February 6, 1926 (R. I-18), proposing a deficiency in income and profits tax against petitioner for the years 1919 and 1920 amounting to $398,400.53 (R. I-18). Petitioner appealed to the Board of Tax Appeals which, on January 17, 1930, rendered its decision eliminating the deficiency proposed (R. I-66). Although the deficiency was eliminated the decision of the Board was in favor of the petitioner taxpayer on only one of the two issues contested before the Board, referred to herein as the bonus and expense points. The contentions of the taxpayer prevailed as to the bonus point and the contentions of the Commissioner prevailed as to the expense point.

Separate appeals were taken by the Commissioner and the taxpayer to the Circuit Court of Appeals, Ninth Circuit (R. II-253 and I-63), and that Court on January 11, 1932, handed down decisions reversing the Board of Tax Appeals on the bonus point and affirming the Board on the expense point, thus making the ultimate decision on both points in favor of the Commissioner (R. II-296). Rehearing was denied (R. II-297). The taxpayer then abandoned its contentions on the expense point. Certiorari was granted by order filed May 31, 1932 (R. II-304).

(2)

Facts Involved.

Prior to March 1, 1913, the taxpayer petitioner acquired in fee two parcels of real estate in California, commonly referred to as the Coyote and Whittier properties (R. I-47). Oil and gas were found upon the properties and, on March 1, 1913, and subsequently, they were both producing. On December 1, 1913, the taxpayer leased the properties to the Standard Oil Company of California for a term of forty years for the purpose of developing and producing oil and gas (R. I-50). The lessor reserved a one-fourth royalty and the lessee agreed to and did pay in installments from 1913 to 1918, inclusive, and "independently of and in addition to royalties", a so-called bonus of $5,500,000.00. The payment of this bonus was not dependent upon production (R. I-59). Personal property was transferred in connection with the lease to which the Commissioner allocated $326,404.82, leaving a net bonus of $5,173,595.18 (R. I-51). The Commissioner allocated this bonus between the properties, $4,517,402.70 to the Coyoté property and $656,192.48 to the Whittier property (R. I-52).

Since the properties were acquired prior to March 1, 1913, the basis of the taxpayer for computing depletion is the value on March 1, 1913. That value has been found by the Commissioner to be $15,710,899.52 for the Coyote properties and $1,450,207.08 for the Whittier properties, and is not in dispute (R. II-272).*

---

* Since the opinion of the Circuit Court of Appeals mentions only the Coyote properties (see Depletion Schedule, R. II-270 and 271) the figure in the text above for the Coyote properties will be used in this brief with the understanding that the same principles are also applicable to the depletion of the Whittier properties.

Pursuant to Article 215 (a) of Regulations 45 as then in effect (1920 edition) and before amendment by Treasury Decision 3938, C.B. V-2, p. 117, this bonus was treated in the deficiency letter issued by the Commissioner as a return of capital and the entire bonus was applied in reduction of the value at March 1, 1913, which was the basis for depletion (R. I-18). The petitioner appealed to the Board on the ground that the bonus was not a *return of capital* but was *income* (R. I-6). The Commissioner answered and this issue was tried. Subsequent to the trial the Commissioner "confessed error" in his brief (R. I-58), changing his position in accordance with the then recently issued amendment of Article 215 (a) of Regulations 45 by Treasury Decision 3938, *supra,* which provided that bonuses were to be treated not as a return of capital but as income and that a certain amount of depletion, according to the formula provided in the amended regulation, should be allocated to the bonus income as received irrespective of when oil was produced from the properties.

The Board held that the revised regulation was invalid (R. I-60). It likewise impliedly rejected the principle of the earlier regulation. It sustained the petitioner's method of computing depletion. In reversing the Board of Tax Appeals the Circuit Court of Appeals approved the amended regulation* and its principle of offsetting depletion against the bonus (R. II-290). The effect of the decision of the Circuit Court of Appeals is to affirm the deficiency originally proposed of $398,400.53.

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* The opinion of the Circuit Court of Appeals as reported in the record (R. II-268 to 295), contains an error in the sentence (at page 290): "The regulation is not only in conflict with the statute, but directly conforms thereto." The word "not" was omitted after the word "only."

(3)

Question Presented.

Petitioner, Murphy Oil Company, owned the fee of the Coyote and Whittier oil properties on March 1, 1913. The March 1, 1913 value of these properties is not in dispute. This value represents the capital of petitioner on March 1, 1913, which by virtue of the statute in the manner therein provided it should be allowed to recover tax-free. When such recovery is allowed through depletion, this capital sum is called "Depletable Base."

The ultimate issue herein involved is whether, in determining petitioner's depletion deductions for the years 1919 and 1920, its depletable base (the March 1, 1913 value) should be reduced by the amount of the bonus received by petitioner under the lease dated December 1, 1913.

IV.

ARGUMENT.

Statute and Regulations Involved.

Sec. 234 (a) (9) of the Revenue Act of 1918 (40 Stat. 1057), reads as follows:

> "Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions: • • •
>
> "(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements,

according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided, further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;"

Before amendment Article 215 (a) of Regulations 45, in its 1920 edition, provided (italics ours):

"(a) Where a lessor receives a bonus or other sum in addition to royalties, *such bonus or other sum shall be regarded as a return of capital to the lessor,* but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The

bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

By Treasury Decision 3938, *supra,* this article was on November 13, 1926, amended to read as follows (italics ours):

"(a) Where a lessor receives a bonus in addition to royalties, *there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received.* Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

* * * * * * *

"(d) Upon the expiration, termination, or abandonment of the lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account the excess of the depletion theretofore allowable in respect of the bonus and royalty payments over the actual depletion or loss in value sustained as a result of the operations under the lease, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned."

Preliminary Discussion.

The taxpayer, under its lease with the Standard Oil Company, dated December 1, 1913, received in addition to

royalties in oil a cash bonus of $5,500,000.00, part of which has been allocated by the Commissioner to the sale of personal property transferred to the Standard Oil Company by the lease (R. I-51), leaving a net bonus of $5,173,595.18. The instant case is concerned with the proper treatment of this bonus for income tax purposes, particularly as regards depletion.

The question is not merely a problem of depletion but reaches into the fundamental purposes of Congress in its desire to protect taxpayers from a tax on capital.

Income has been generically defined as "'. . . the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through sale or conversion of capital assets . . .'"*

Machinery has been devised in connection with the third type of income enumerated in the quotation—"profit gained through sale or conversion of capital assets"—to avoid a tax upon the taxpayer's investment in capital assets sold or converted. In the case of outright dispositions of property this protection is a matter of constitutional necessity.** If the disposition is gradual, as it is when mineral properties are operated, the protection is to be deduced from the fundamental intent of Congress to afford equality of treatment to all taxpayers and to give by statute in the case of gradual disposition of capital what is given by the constitution in the case of outright disposition. For these

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* *Eisner* vs. *Macomber*, 252 U. S. 189, at page 207; *Merchants' Loan & Trust Co.* vs. *Smietanka*, 255 U. S. 509; *Stratton's Independence, Limited* vs. *Howbert*, 231 U. S. 399; *Doyle* vs. *Mitchell Bros. Co.*, 247 U. S. 179.

** See particularly *Burnet* vs. *Thompson Oil & Gas Co.*, 283 U. S. 301, at page 307, reversing 40 F. (2d) 493 (C. C. A. 10th, 1930), and in effect affirming 15 B. T. A. 993, and citing *Doyle* vs. *Mitchell Bros. Co.*, 247 U. S. 179.

reasons the question involved herein goes to basic concepts of the income tax law and is of outstanding importance.

Depletion, as the word is used in the income tax statutes, is limited in its application to the exhaustion of natural resources. Whatever it may be in the field of economics or accountancy, depletion is for income tax purposes a creature of the statute, since its allowance is a matter of grace and not of right. *

Technically, the problem in the instant case is solely one of the correct interpretation of the above quoted statutory provision. However, the statute itself does not define depletion; it prescribes no method of computing depletion. The problem of statutory interpretation, therefore, requires a resort to general principles.

It is the position of the taxpayer in the instant case that the word "depletion," as used in Section 234 (a) (9), must be interpreted, under the well-established rule of statutory construction, according to its ordinary, familiar and natural meaning,** and that that meaning is established beyond argument by court decisions and the practice of the Bureau of Internal Revenue. While the meaning of the word is the basic point to be considered and finally dictates the conclusion to be reached, it is necessary to consider the question not only from the viewpoint of the statute and the decided cases but also to set forth exactly how the problem arises in the instant case.

At the outset it should be noted that the depletion deduction is kindred to the depreciation deduction.*** Nevertheless, the methods of computing depreciation and deple-

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* *Stanton* vs. *Baltic Mining Co.*, 240 U. S. 103; *Burnet* vs. *Thompson Oil & Gas Co., supra.*

** *DeGanay* vs. *Lederer*, 250 U. S. 376.

*** *United States* vs. *Ludey*, 274 U. S. 295, 303.

tion are generally different. Depreciation is in most cases computed on the so-called "straight-line" basis. Under this method the depreciation base (cost or value at March 1, 1913) is divided by the number of years of remaining useful life of the property and the quotient is the annual allowance. This method is based upon the fiction that depreciation occurs evenly year by year and that the depreciation allowance for a particular year is a proportional part, on a time basis, of the depreciation base.

This method of computing depreciation is dictated by necessity. It is usually impossible to measure the amount of depreciation which has occurred in a fixed period of time. It is usually impossible to say how much a building has exhausted its useful life in one year as compared with another year.

However, absolute exactness is possible in allocating depletion over the years and this fact explains the disparity between the methods adopted for computing *depletion* and *depreciation.* The method adopted for computing depletion is the unit-of-production method and, as applied by the Commissioner, involved the use of a diminishing balance.* The two members of the equation are: (1) the depletable base (cost or value at March 1, 1913), and (2) the number of mineral units or reserves in the property at that date. Once these two factors are determined, the unit-of-production method measures with absolute accuracy the depletion allowance for a particular period of time, since it is determined by the actual production of the period, which can be computed with complete precision.

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* This method has been approved in the only case reaching this Court involving the depletion *method* as distinguished from more general problems of depletion. See quotation, *infra,* page 26, from *Burnet* vs. *Thompson Oil & Gas Co., supra.*

It should be noted in addition that any method of computing depletion other than the unit-of-production method, and particularly the straight-line method, completely misrepresents the physical fact of exhaustion which is the fundamental reason for the depletion deduction. It is impossible, as of March 1, 1913, to estimate the useful life of a mineral property in terms of years; further, depletion in the sense of exhaustion of the reserves of a mineral property ordinarily takes place unevenly over the years, rendering the straight-line method absolutely valueless as a system for determining the depletion allowance for the year.

These general principles furnish the background for the method adopted in computing the annual depletion allowance and are highly important because of the fixed principle that the income tax is one "for annual periods."*

Under the unit-of-production method the depletable base of the taxpayer is divided by the number of mineral units in the property and the quotient is the depletion unit. This unit is then multiplied by the reserves taken from the property in the year; the product is the depletion allowance for the year.

The factors, therefore, which are necessary to compute the depletion allowance for mineral properties are: (1) the depletable base, and (2) the number of units of mineral reserves to which this base is applicable. The diminishing balance method involves the reduction each year of (1) the depletable base by the amount of depletion allowed for the year, and (2) the mineral reserves by the number of units extracted during the year.

This is the method which the Commissioner has prescribed for lessors where no bonus is involved. It is the

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* *Burnet* vs. *Thompson Oil & Gas Co., supra,* at page 306.

method which this Honorable Court has approved in *Burnet* vs. *Thompson Oil & Gas Co., supra.** It is the method which this petitioner is advocating. The Commissioner, however, in the instant case has used a different method because of the payment of a bonus to the taxpayer. He has treated the bonus as a return of capital and applied it in reduction of the depletable base (March 1, 1913 value) of the oil reserves.

A simple example expressed in round numbers will serve to illustrate the difference between the Commissioner's method and that advocated by the petitioner herein. In the example following the first column represents the petitioner's method, and the second column shows the effect of the Commissioner's action when a bonus is injected into the imaginary case furnished by the example:

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* See quotation from the Board opinion in this case on page 24.

	Petitioner's Method	*Commissioner's Method*
1. Depletable base (value at March 1, 1913)	$2,000,000.00	$2,000,000.00
2. Reserves at March 1, 1913, in barrels	4,000,000	4,000,000
3. Value per barrel (Depletion unit)	$ 0.50	$ 0.50
4. Production March 1, 1913, to December 1, 1913, in barrels	100,000	100,000
5. Depletion sustained March 1, 1913, to December 1, 1913 (Item 4 times Item 3)	$ 50,000.00	$ 50,000.00
6. Depletable base remaining December 1, 1913 (Item 1 minus Item 5)	$1,950,000.00	$1,950,000.00
7. Bonus received	$ 500,000.00	$ 500,000.00
8. Depletable base remaining after receipt of bonus (Item 6 minus Item 7)	$1,950,000.00	$1,450,000.00
9. Remaining Reserves, December 1, 1913, in barrels (Item 2 minus Item 4)	3,900,000	3,900,000
10. Depletion Unit (Item 8 divided by Item 9)	$ 0.50	$ 0.3718
11. Production December 1, 1913, to December 31, 1918, in barrels	2,000,000	2,000,000
12. Depletion sustained December 1, 1913, to December 31, 1918 (Item 10 times Item 11)	$1,000,000.00	$ 743,600.00
13. Depletable base remaining January 1, 1919 (Item 8 minus Item 12)	$ 950,000.00	$ 706,400.00
14. Remaining Reserves (Item 9 minus Item 11)	1,900,000	1,900,000
15. Depletion Unit (Item 13 divided by Item 14)	$ 0.50	$ 0.3718
16. Production in 1919, in barrels	100,000	100,000
17. Depletion sustained in 1919 (Item 15 times Item 16)*	$ 50,000.00	$ 37,180.00

* The above example illustrates what the Commissioner has done in the instant case. The Commissioner's method as applied in the instant case is not in strict mathematical accordance with the amended regulation in that depletion deductions subsequent to the date of the lease were computed upon a production basis rather than the royalties received basis required by the amended regulation. The effect, however, of the application of the method prescribed in the regulations is the same as in the above example in that it allocates depletion deductions to the bonus payments and not to the actual exhaustion of reserves.

The bonus received of $500,000 does not reduce the depletable base under the petitioner's method, items 7 and 8, to $1,450,000 as it does under the Commissioner's method, because it was income and did not involve any exhaustion of the properties. This is the essential difference between the petitioner and the Commissioner in the instant case.

The loss in the depletion allowance for the year 1919 on account of the reduction of the deductible base by the bonus as per the above example is $12,820.00, the difference between the amounts in the two columns in item 17.

In the instant case the Commissioner has applied the bonus in reduction of the taxpayer's depletable base without, as the above example demonstrates, a corresponding decrease of the reserves (there being no production allocable to the bonus). The result is that the depletion unit is lowered, the depletion allowance is decreased, the taxpayer's income is increased, and the deficiency here in question is asserted.

Had the diminishing balance method been followed, during the period March 1, 1913 to January 1, 1919, the reduction of depletable base would have paralleled the reduction of the taxpayer's mineral reserves, leaving the depletion unit the same. There would not have been a reduction of the depletable base without a reduction of the oil of which it is the expression in dollars. Obviously since the taxpayer's capital is oil, it can be reduced only by the extraction of oil (or by being converted into monied capital through sale). The mere statement of the result of the Commissioner's action indicates its fallacy.

Under the diminishing balance method the depletion unit is the depletable base divided by the barrels of oil in the property. The barrels of production in a given period

are multiplied by this depletion unit to obtain the depletion allowance for the period. The depletable base is reduced by the depletion sustained and allowed. Correspondingly, the reserves are diminished by the production. The two constantly parallel each other. The result is a constant depletion unit.

When it is considered that the taxpayer's depletable base is oil expressed in dollars for the sake of convenience of computation (we must have, for tax purposes, a common unit of measurement, the dollar), it is apparent that the diminishing balance method is the correct one since it reduces the capital (oil) only when oil is extracted. The mere receipt of dollars is not indicative of return of capital.

The taxpayer's depletable base, which is the value of its properties at March 1, 1913, was $15,710,899.52. The production of the period March 1, 1913, to January 1, 1919, according to the diminishing balance method, would reduce this depletable base and would correspondingly reduce the taxpayer's mineral reserves, leaving the depletion unit the same. The Commissioner reduced the depletable base remaining as of January 1, 1919, not only on account of previously sustained depletion but also by the amount of the bonus *without any corresponding reduction of the reserves to which the depletable base was applicable;* he could not reduce the reserves since they were still in the property at January 1, 1919.

It is the contention of the taxpayer that the essential effect of this procedure of the Commissioner was to allocate *anticipatory* depletion to years when there has been no corresponding exhaustion of the property and that the procedure is based upon an unwarranted construction of Section 234(a)(9). In other words, the Commissioner by his

action has deprived the taxpayer of depletion to which it was entitled in 1919 and 1920 by allocating depletion to years prior thereto in accordance with a formula based upon *income from*, as distinguished from *exhaustion of*, the taxpayer's property.

The above preliminary discussion should be enough to show the injustice of applying the amended regulation. If it is argued in favor of the amended regulation that it works a more equitable result, the strictly legal answer is that a statute must be construed according to its terms and the intent apparent on its face.* However, it is obvious that the amended regulation does not work a more equitable result. The amended regulation under discussion was not promulgated until 1926. It superseded the regulation treating bonuses as a return of capital which went into effect in January, 1921. Prior to 1921 bonuses were treated not as a return of capital but as income and no depletion was allowed in respect thereto. The harsh result is obvious that taxpayers receiving bonuses in years when they were regarded as income and in which no depletion was allocable

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* The above principle has been forcefully stated in *People ex rel., Studebaker Corp.* vs. *Gilchrist*, 244 N. Y. 114, at page 125, as follows:

> "* * * The taxing officers of the State are mere administrative agents. They may not devise new forms and methods of taxation, however convenient or useful. * * * Assessment, however handy, must find its warrant in the statute. A statute levying a tax will not be extended by implication beyond the clear import of its terms (Gould *v.* Gould, 245 U. S. 151, 153). If one method of assessment or collection is pointed out, the courts will not permit the application of another on the theory that the Legislature might just as well have chosen it, since in the final devolution of the burden the result will be the same, or, at worst, not widely different (U. S. *v.* Field, 255 U. S. 257; Stebbins *v.* Kay, 123 N. Y. 31; People *ex rel.*, Mutual Trust Co. *v.* Miller, 177 N. Y. 51). We take the statute as we find it."

thereto will never secure the benefit of the depletion allocable thereto in accordance with the amended regulation. In other words, taxpayers in this position have paid a tax on sums received, part of which under the amended regulation should be regarded as tax-free by way of depletion. Neither did such taxpayers secure the benefit of the return-of-capital theory underlying the 1920 edition of the regulations.

We shall now proceed tc a more detailed statement of the petitioner's position.

POINT I.

The transaction between the taxpayer, Murphy Oil Company, and the Standard Oil Company of California, evidenced by lease dated December 1, 1913, did not constitute a sale of taxpayer's mineral properties and the bonus of $5,173,595.18 received by the Murphy Oil Company was not purchase price, and, therefore, did not represent a return of its capital.

If the transaction of December 1, 1913, constituted a sale by the Murphy Oil Company to the Standard Oil Company, then the payments to be made by the Standard Oil Company, including the bonus, are purchase price and the treatment of them for income tax purposes would not involve the question of depletion at all since a person who has parted with property is no longer entitled to depletion with respect thereto.* The transaction cannot be half sale and

* See *Pugh* vs. *Commissioner*, 49 F. (2d) 76 (C. C. A. 5th, 1931), in effect affirming 17 B. T. A. 429, certiorari denied, 52 S. Ct. 22; *Herold* vs. *Commissioner*, 42 F. (2d) 942 (C. C. A. 5th, 1930), in effect affirming and reversing 17 B. T. A. 933; *Waller* vs. *Commissioner*, 40 F. (2d) 892 (C. C. A. 5th, 1930), affirming 16 B. T. A. 574, certiorari denied, 51 S. Ct. 101; *Palmer* vs. *Bender*, 57 F. (2d) 32 (C. C. A. 5th, 1932), affirming 49 F. (2d) 316.

half lease. Neither can the consideration moving to Murphy Oil Company be part purchase price and part rent or royalty; the bonus and the royalties in oil are either both purchase price or neither of them are. There can be no middle ground. It is desirable, therefore, at the outset to discuss the nature of the transaction.

The Commissioner recognizes that a lease of oil properties does not constitute a sale of the mineral products. He admitted in his brief before the Circuit Court of Appeals that the taxpayer's lease, dated December 1, 1913, did not constitute a sale. Indeed, his admission could not be otherwise in view of the terms of the lease itself, the following provisions of which clearly connote a lease and are positively inconsistent with a sale:

(1) The interest of the Standard Oil Company is limited in time to a term of forty years (R. II-186).

(2) The Murphy Oil Company reserves certain very substantial royalties (R. II-189 and 195).

(3) Various obligations are imposed upon the Standard Oil Company, such as the duty to drill wells (R. II-195).

(4) The parties have themselves expressed the intention that the instrument shall constitute a lease and not a sale (R. II-186).

(5) The instrument contains limitations upon assignment, underletting or subletting (R. II-217 and 218).

(6) The instrument provides for the division of the burden of payment of taxes (R. II-215).

(7) The instrument contains a forfeiture clause (R. II-205 and 208).

The foregoing provisions conclusively demonstrate that the instrument was a lease and not a sale. Therefore, the bonus was income* and the reduction of lessor's depletable base by the amount of the bonus is entirely without justification on the theory of return of capital.

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* See *Work* vs. *Mosier,* 261 U. S. 352, which involved a bonus and the following cases which involved ordinary royalties from mineral properties: *Stratton's Independence, Limited* vs. *Howbert, supra; United States* vs. *Biwabik Mining Co.,* 247 U. S. 116; *Stanton* vs. *Baltic Mining Co., supra; Von Baumbach* vs. *Sargent Land Co.,* 242 U. S. 503. Additional authorities for this point are furnished by the several decisions of the lower federal courts, some of which involve the question whether royalties are taxable as the proceeds of a conversion of capital assets: *Alexander* vs. *King,* 46 F. (2d) 235 (C. C. A. 10th, 1931), reversing 38 F. (2d) 256; *Berg* vs. *Commissioner,* 33 F. (2d) 641 (App. D. C., 1929), affirming 6 B. T. A. 1287, certiorari denied, 280 U. S. 598; *Burkett* vs. *Commissioner,* 31 F. (2d) 667 (C. C. A. 8th, 1929), affirming 7 B. T. A. 560, certiorari denied, 280 U. S. 565; see also *Weiss* vs. *Wiener,* 279 U. S. 333, reversing 27 F. (2d) 200 (C. C. A. 6th, 1928), which reversed 17 F. (2d) 650; *Rosenberger* vs. *McCaughn,* 25 F. (2d) 699 (C. C. A. 3d, 1928), certiorari denied, 278 U. S. 604; *New Creek Co.* vs. *Lederer,* 295 Fed. 433 (C. C. A. 3d, 1924), affirming 288 Fed. 99. In addition, see the line of cases to the effect that bonuses in connection with ordinary non-mineral leases are income. *Crile* vs. *Commissioner,* 55 F. (2d) 804 (C. C. A. 6th, 1932), certiorari applied for May 5, 1932; *O'Day Investment Co.,* 13 B. T. A. 1230; *James M. Butler,* 19 B. T. A. 718; *Douglas Properties, Inc.,* 21 B. T. A. 347; *Edward E. Haverstick,* 13 B. T. A. 837.

POINT II.

The amended regulation of the Commissioner, as upheld by the Circuit Court of Appeals, requiring the reduction of petitioner's depletable base to the extent of the bonus, violates the statutory concept of depletion, in basing depletion upon receipt of income rather than upon actual exhaustion of the mineral reserves.

The contentions of the petitioner herein are in accordance with the decision of the Board of Tax Appeals which was reversed by the Circuit Court of Appeals. The Board of Tax Appeals held:

> (1) that the instrument of December 1st, 1913, was a lease and did not effect a sale of the taxpayer's properties;
>
> (2) that the taxpayer did not, in receiving the bonus, receive a return of capital but received income;
>
> (3) that the determination of the Commissioner in the deficiency letter was erroneous in treating the bonus as a return of capital and applying the same in reduction of the petitioner's depletable base; and
>
> (4) that neither could the Commissioner's deficiency be sustained on the theory of the amended regulation which provides that a certain amount of depletion is allowable in respect of the bonus, this theory being untenable because it constituted a "departure from the depletion concept."

The Board of Tax Appeals recognized that under the instrument of December 1, 1913, the bonus was payable "independently of and in addition to the royalties and other considerations" stated in the lease. The Board said (R. I-159):

"The bonus payment in the instant case was a part of the consideration paid for the lease. While expected production undoubtedly was considered in fixing the amount of the bonus, it is elementary under the laws governing such agreements that its payment did not, in anywise, depend upon, or relate to, production. The lessee's liability therefor was fixed by the terms of the contract. On the other hand, the operation of the principle of depletion depends upon exhaustion of resources through production—i.e., the recovery of capital through its conversion from the form of oil resources or reserves into marketable products or the equivalent received for such product. Under such principle the depletion allowance for the year or years of the bonus payments can only be measured by reference to the oil produced. If, as we have pointed out, the bonus is income, no part of which represents recovery of capital, it follows that any depletion allowance against such income is a departure from the depletion concept. The regulation relied on by the respondent is clearly such a departure. While it might, in some cases at least, produce a more equitable result, the statutory allowance may not be so varied by administrative regulation."

The correctness of the Board's conclusion as to the nature of the instrument of December 1, 1913, and its conclusion that no capital was returned to the taxpayer by virtue of the bonus has been discussed in Point I. There remains to be discussed the depletion concept which the petitioner contends is violated by the amended regulation sustained by the Circuit Court of Appeals.

Article 215 (a) as amended, *supra,* purports to be an interpretation of section 234 (a) (9) of the Revenue Act of 1918 which provides for a depletion deduction.

In a number of cases this Honorable Court has adopted for the word "depletion" its plain, ordinary and natural meaning* and has held that depletion is measured by and is limited to the amount of product mined and sold during the year.

In *United States* vs. *Ludey, supra,* at page 302, this Court, referring to the depletion provision said:

> "The depletion charge * * * represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment."

Again in *Lynch* vs. *Alworth-Stephens Co.,* 267 U. S. 364, this Court said, at page 369 (italics ours):

> "In the case of mines, a specific kind of property, the exhaustion is described as depletion, * * *. The interest of respondent under its leases in the mines being property, its right to deduct a reasonable allowance for exhaustion of such property, *if there be any,* during the taxable year, results from the plain terms of the statute, such deduction, since the property is an interest in mines, to be limited to the amount of the exhaustion of respondent's interest caused by the depletion of the mines during the taxable year. We agree with the circuit court of appeals * * * that 'the plain, clear, and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to every one whose property right and interest therein have been depleted by the extraction and disposition "of

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* *DeGanay* vs. *Lederer, supra.*

> the product thereof which has been mined and sold during the year for which the return and computation are made" * * *."*

The idea of exhaustion of reserves as fundamental to the meaning of the word depletion has been given emphasis by the Board of Tax Appeals in its opinion approved by this Court in the *Thompson* case, *supra*. The Board said (15 B. T. A. at page 997):

> "That a reasonable allowance for the depletion of a wasting or exhaustible asset, such as we have here, will be obtained by considering that the recoverable value will become exhausted in the same ratio as that which gives value to the asset disappears, can hardly be questioned. Lynch *v.* Alworth-Stephens Co., 267 U. S. 364. For example, if at January 1, 1917, a taxpayer had purchased a leasehold for the recovery of oil at a cost of $100,000 with oil to be recovered of 400,000 barrels, and if, during 1918, 100,000 barrels had been produced, a depletion allowance of $25,000, or 25 cents per barrel would certainly be accepted as the reasonable depletion allowance for 1918."

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* See also *Stratton's Independence, Limited* vs. *Howbert, supra; Von Baumbach* vs. *Sargent Land Co.*, 242 U. S. 503; *Goldfield Consolidated Mines Co.*, vs. *Scott*, 247 U. S. 126. In all of these cases the depletion or "depreciation" claimed was on the basis of tonnage or other unit produced during the taxable year. In the *Von Baumbach* case this Court said, page 525 (italics ours):

> "It is equally true that there seems to be a hardship in taxing such receipts as income, without some deduction *arising from the fact that the mining property is being continually reduced by the removal of the minerals.* But such consideration will not justify this court in attributing to depreciation a sense which we do not believe Congress intended to give to it in the Act of 1909."

In the *Goldfield* case the terms "depletion" and "exhaustion" were used synonymously. See statement of questions presented, 247 U. S., at page 130.

The regulations promulgated by the Commissioner repeatedly refer to the exhaustion of the mineral and timber reserves as a basis for computing depletion.* The attention of the Court is also directed to A. R. M. 148, C. B. I-1, p. 186, in which it is stated, at page 187:

> "Where no mineral is produced upon the premises it follows that the interest of the taxpayer in the mineral reserves is not affected and that no allowance can be made for depletion."

In A. R. R. 1147, C. B. I-2, p. 138, this principle was extended even to advance royalties. It is stated in this ruling that, at page 139:

> "* * * a taxpayer who received during 1917 advance royalties on coal to apply against future mining operations was not entitled to a depletion deduction from income because no coal had been extracted."

The above line of cases establishes the meaning of the word "depletion" and associates it definitely and finally with exhaustion of the depletable property. The absolute condition precedent to the allowance of the deduction for depletion is the exhaustion or consumption of the reserves which are subject to depletion. The Commissioner's regulation, which requires the deduction of depletion with respect to a bonus not related to production, is therefore in direct conflict with the statute. No one disputes the fact

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* As an example, see Article 210 of Regulations 45 which says that depletion "attaches to the annual production" and Article 229 of Regulations 45, which states that the allowance for depletion of timber in any taxable year "shall be based upon the number of units of timber felled during the year." Corresponding provisions are contained in the later regulations (Reg. 62, Art. 210, 229; Reg. 65, Art. 211, 231; Reg. 69, Art. 229; Reg. 74, Art. 249).

that the taxpayer is entitled to depletion in the instant case aggregating $15,710,899.52, the established market value at March 1, 1913, of the taxpayer's property. The real issue is how much of this depletion the taxpayer is entitled to deduct in the taxable years 1919 and 1920. It is for that reason that the principle allocating depletion to extraction or exhaustion, as opposed to the receipt of income, becomes important.

It becomes necessary, therefore, to discuss the decision of this Court in *Burnet* vs. *Thompson Oil & Gas Co., supra.* In that case this Court had under consideration the question whether in determining depletion under the 1918 Act there should be deducted from the depletable base the depletion actually sustained in earlier years or only so much of the actually sustained depletion as had been allowable as deductions under earlier revenue acts which allowed only a percentage of production as depletion. This percentage allowance had, as a matter of fact, fallen about $85,000.00 short of the depletion actually sustained, *i. e.,* the amount by which the reserves of oil had been exhausted. The taxpayer argued that only the depletion *allowed* should be used to reduce the depletable base. The Commissioner argued that the entire amount of *sustained depletion* should reduce the depletable base. This Court sustained the Commissioner. The opinion states, at page 306:

> "The tax is an income tax for 1918, and in the absence of express provision to the contrary, it is not to be supposed that the taxpayer is authorized to deduct from that year's income, depreciation, depletion, business losses or other similar items attributable to other years. * * * The construction adopted by the Court below in effect results in including in the taxable year items referrable to other

years, and is contrary to the theory of a tax for specific years.

"The nature of the tax as one for annual periods has been repeatedly mentioned in dealing with its application in various situations. The taxable year 1918, and that only, is involved, and deductions applicable to that year only should be allowed."

The taxes in the instant case are income taxes for the years 1919 and 1920. In the absence of express provision to the contrary, it is not to be supposed that the taxpayer is to be denied deductions for depletion actually sustained in those years because of theoretical depletion deductions (not based upon exhaustion) which the Commissioner now wishes to allocate to prior taxable years.

The construction adopted by the Commissioner is contrary to the theory of a tax for specific years. The nature of the tax as one for annual periods has been repeatedly mentioned in dealing with its application in various situations. The taxable years 1919 and 1920, and those only, are involved in the instant case, and deductions applicable to those years and granted by the statute should be allowed.

This is the thoroughly established depletion concept, sanctioned by this Court in the *Thompson* case, *supra,* and which the Board said the Commissioner had departed from in the case at bar by deducting the bonus from the taxpayer's depletable base. The Commissioner himself has never made any attempt, except in bonus cases, to apply the principle upon which must rest his treatment of the bonus in the instant case.

Since a bonus and ordinary royalties are both income,* there is no legal justification for making a distinction with

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* See page 20, footnote *.

respect to depletion allowance between a lessor receiving a cash bonus and a lessor not receiving a cash bonus. Moreover, depletion and depreciation are kindred deductions* and if the depletion deduction is to depend upon income as the Commissioner's amended regulation requires, then certainly the depreciation and obsolescence deductions should likewise depend upon the amount of income received.

There is no need to dwell on the radical and far-reaching consequences of the general acceptance for all depreciation and depletion cases of the doctrine of Article 215 (a) as amended. The doctrine is irreconcilable with the underlying principle governing the computation of depletion in non-bonus cases. Its acceptance would mean that the production *of the year* would be abandoned as determining the taxpayer's depletion allowance *for the year* and that the allowance would be determined on a *dollar* basis instead of a *barrel* basis. This would mean that the exhaustion of depletable property would have no relationship to the depletion allowance and that instead the depletion allowance would fluctuate according to such irrelevant, fortuitous and variable considerations as the price of oil. There would be no stability of method left in determining the annual depletion allowance. The allowance could never be determined with the accuracy inherent in the method invariably employed in cases not involving a bonus. The general acceptance of the concept of regulating depletion for the year according to income would place depletion on a wholly artificial basis and introduce into the administration of the depletion provision almost insuperable difficulties.

The allowance for depletion and the allowance for depreciation of improvements on mineral properties are in-

* *United States* vs. *Ludey, supra.*

timately connected in the statute, provision being made therefor in the same paragraph, this type of depreciation being provided for separately from depreciation generally with respect to other types of property. It may be wondered parenthetically why Article 215 (a) of Regulations 45, as amended by Treasury Decision 3938, *supra,* is restricted to *depletion.* No reason whatever appears why depreciation of improvements, which is also frequently computed according to the unit-of-production method, should not also be determined on an income basis, a part of the depreciation of improvements being allocated to any bonus received. In this respect the Commissioner has failed to carry to its logical conclusion the principles of determining the deduction on an income basis.

The depletion provisions of the 1918 Act are unambiguous. Where that is true of a statutory provision, there is no room for construction and interpretation or a reference to matters of expediency. However, whatever doubt may lurk in the statute should be resolved by referring to an interpretation which will save inconvenience, injustice and confusion.* It would be difficult, if not impossible, to devise a more sensible and practical method of computing the depletion allowance for a taxable period than by reference to the exhaustion taking place in that period. The formula adopted in Article 215 (a) as amended, has as one of its elements "royalties expected to be received" from the property. Who can tell with the slightest pretense of precision in the early years of operation what these royalties will be? The speculative character of any estimate or prophecy of them is obvious. This introduces a highly

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* *Woolford Realty Co., Inc.* vs. *Rose,* 52 S. Ct. 568; *Bankers' Trust Co.* vs. *Bowers,* 295 Fed. 89 (C. C. A. 2d, 1923).

problematical factor into the computation of depletion on the basis of income.* The probable result is that the depletion for a particular year will be measured not by income but by an inaccurate estimate of income; thus, not even the result theoretically intended is accomplished. It could not, as a matter of fact, be accomplished until the exhaustion of property and until the entire income derived therefrom became a known quantity. Only then may income serve accurately as the basis for the division of the depletion allowance among the years.

On the other hand, the production or barrel basis for calculating depletion reaches a result of absolute accuracy each year. The problem before Congress was to provide an accurate depletion allowance that could be given to taxpayers within a reasonable time, not in the dim future when the property became finally exhausted. Is it to be for a moment supposed that in using the word "depletion" Congress had in mind the adoption of a meaning for the term which would produce such absurd results?

Even more disastrously far-reaching consequences of any general acceptance of the principle underlying the Commissioner's treatment of the bonus in the instant case should perhaps be placed before the Court. In bonus cases, where the bonus is payable independently of production, it is never certain until there is production that the property will be exhausted. Many easily imaginable interventions may occur resulting in no production whatever. In the instant case the Standard Oil Company after paying

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* This Court in *Burnet* vs. *Logan*, 283 U. S. 404, at page 412, said:

> "The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation."

the bonus, for any number of conceivable reasons, might never have produced a drop of oil from the Whittier and Coyote fields. It might have concluded, after making the lease and paying the bonus, that it could not profit from production from the property, that it had made a bad bargain, and it might completely have abandoned the lease. For many other reasons the lease might have been forfeited before any oil was produced. The result of the Commissioner's theory of depletion would be that a taxpayer would have offset income with depletion which never occurred. After receiving millions of dollars from the property, the property might be returned to the taxpayer with no diminishment whatever of its reserves of oil.* Is it conceivable that Congress could have intended to allow depletion to a taxpayer under such circumstances?

The ordinary meaning of the word "depletion," which must be resorted to, ** refers to exhaustion of the depletable property.

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* This difficulty is recognized in Article 215(d) of Regulations 45 (and corresponding later regulations) in the provision for expiration, termination or abandonment of a lease without the removal of any or all of the mineral. Under Paragraph (d) of both the 1920 Edition of Article 215 and the Article as amended by Treasury Decision 3938, *supra*, the lessor is required to restore to capital account the excess of depletion theretofore allowable in respect of the bonus and royalty payments over the actual depletion or loss in value sustained as a result of operations and the corresponding amount must be returned as income for the year in which the lease expires, terminates or is abandoned. Would it not be simpler, and distort income less seriously, to recognize exhaustion in the first instance as the factor governing the depletion allowance? The effect of the procedure outlined in the regulation is a transfer of bonus income from the earlier year of receipt or accrual to the later year of abandonment,—a distortion which would be wholly unnecessary if the first incorrect step were not taken of placing depletion in the wrong year. The provision shows an attempt to correct one mistake by making another. In this connection see page 52.

** *De Ganay* vs. *Lederer, supra.*

Neither the Commissioner nor the Secretary of the Treasury can by his regulations alter or amend a revenue law, nor put into the body of the statute a limitation which Congress did not think it necessary to prescribe. *Morrill* vs. *Jones,* 106 U. S. 466.

The applicable principle has been nowhere more strikingly stated than in the opinion of this Court in the case cited so frequently against this taxpayer, *Lynch* vs. *Alworth-Stephens Co., supra,* in which it was said at page 370:

> "'* * * And the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover.' "

To allow a deduction independently of exhaustion is plainly to misapply and pervert the "obvious and rational meaning" of the statute. It leads into practical complexities of calculation that are almost insurmountable and which would enormously increase the difficulty of administering the income tax law. Where Congress has so plainly indicated by the use of the word "depletion" that it preferred the simple practical method of allowing a return of capital as exhaustion takes place, the congressional intent should be respected and the Commissioner's attempted reconstruction of the depletion provision by Article 215(a) as amended on November 13, 1926, should be declared invalid.

POINT III.

Neither the apportionment clause in the depletion provision of the 1918 Act, nor the decision of this Honorable Court in *Lynch* vs. *Alworth-Stephens Co.*, 267 U. S. 364, justifies any elimination from the taxpayer's depletable base on account of the bonus received by it under its lease.

The opinion of the Circuit Court of Appeals indicates that its decision was greatly influenced by the apportionment clause of Section 234 (a) (9) of the Revenue Act of 1918, reading:

> "In the case of leases the deductions [for depletion and depreciation] allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

We believe that the interpretation placed upon the apportionment clause by the Circuit Court of Appeals is entirely erroneous. It suggested that the apportionment clause applies to leases made *after* February 28, 1913, as well as those in effect at March 1, 1913; and it said that the bonus, which is the lessee's cost, must be applied in reduction of the lessor's value at March 1, 1913. The Court of Appeals of the District of Columbia in the case of *Night Hawk Leasing Co.* vs. *Burnet*, 57 F. (2d) 612 (App. D. C. 1932), reversing 19 B. T. A. 258, has gone even further and has held that the making of a lease after February 28, 1913, has the effect of transferring to the lessee a part of the lessor's depletable base-value at March 1, 1913.

Both of these courts construe the apportionment provision in such a way that a lessor making a lease after February 28, 1913, will never receive free from tax by way of depletion allowance the cost of its property or its value at March 1, 1913. The taxpayer in the instant case contends that such an interpretation is violative of the plain language and clear intendment of the depletion provision. The petitioner's contention is that the provision must be interpreted in such a way as to enable the return tax-free to the lessor of cost or value at March 1, 1913. It is submitted that this provision applies only to lessors and lessees under leases in existence on March 1, 1913. But even if it applied to leases made after this date, the taxpayer contends that the apportionment provision still requires the apportionment not only of the lessor's deduction but of all the deductions provided for.

The apportionment clause provides for the apportionment of "the deductions allowed by this paragraph." What are these deductions? They are plainly for depreciation of improvements and for depletion upon one of the three following bases: (1) cost; (2) March 1, 1913, value; (3) discovery value. The granting part of the section, the language giving the deduction, is the first part. As applicable in the instant case there is a clear and unambiguous grant of a depletion deduction based upon the fair market value of the property (or the taxpayer's interest therein) on March 1, 1913, in lieu of cost up to that date. There is nothing equivocal about this language. Its fundamental purpose is clear; it is to afford taxpayers retaining natural resources the same protection as is afforded by the Constitution to taxpayers who sell such property. The provision is a recognition of the fact that the proceeds of the sale

of the products of such wasting properties have in them capital which should not be subjected to tax.

It is an elementary rule of statutory construction that all parts of a statute should be read together and that one part should not be allowed to defeat another part if by any reasonable construction the two can be harmonized.* It is not difficult to harmonize the granting part of this depletion provision and the apportionment clause at the end thereof. Its obvious meaning is to apportion the value at the basic date, March 1, 1913, or date of discovery, among the various interests existing in the property at that date so that each interest will secure the return, tax-free through annual deductions for depletion and depreciation, of its total capital interest. This meaning is completely in harmony with the earlier part of the provision and does not take away from taxpayers what is unequivocably given, viz: an allowance for depletion and depreciation on the bases stated.

We may now turn to the interpretation placed upon the apportionment clause by the opinion of the Circuit Court of Appeals in the instant case. That opinion discusses the bonus question both on principle and authority. The conclusion reached on "principle" is to the effect that the fee valuation of $15,710,899.52 represented the total interest at March 1, 1913, of the taxpayer as *lessor* and of the Standard Oil Company as *lessee* and that no greater sum should be depleted. It is said (R. II-282):

> "The allowance of the total depletion to the lessor, as was required by the decision of the Board of Tax Appeals, left nothing to be apportioned to the interest of the lessee in the property."

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* *Blair* vs. *Chicago*, 201 U. S. 400; *United States* vs. *Ninety-Nine Diamonds*, 139 Fed. 961 (C. C. A. 8th, 1905), affirming 132 Fed. 579.

It should be said parenthetically that the above-quoted remarks of the Circuit Court of Appeals are *obiter dicta* and were entirely unnecessary to its real decision, which indeed is inconsistent with the language quoted. Instances are numerous in which there is no March 1, 1913 value and no cost to the lessor of the mineral reserves and in which bonuses in substantial sums have been received for mineral leases. It would be interesting to speculate as to what the Circuit Court's opinion would have been if the Murphy Oil Company had had no March 1, 1913 value or cost. The Circuit Court said by way of *dicta* that no greater basis could be allowed the combined interests than the March 1, 1913 value of the lessor's interest. Would the Court then refuse depletion altogether to a lessee paying a bonus to a lessor having no March 1, 1913 value?

The *dicta* that not more than $15,547,522.17 (value at December 1, 1913 as assumed by the Circuit Court of Appeals though there was nothing in the record to show value at that date) should be depleted after November 30, 1913, by lessor and lessee cannot be reconciled with the later conclusion of the opinion that Article 215 of Regulations 45, as amended by T. D. 3938, *supra,* is valid. That regulation, to put it simply, permits depletion *to the lessor* with respect to the *entire* March 1, 1913 value. It simply rules that part of that value should be applied against the bonus by providing that the taxpayer lessor shall be entitled to deduct as depletion ". . . that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received."

The thought of the Circuit Court of Appeals in the *dictum* quoted appears to be that the statute provides for

a value at March 1, 1913, in the case of properties owned prior to that date, a part of which value is taken as a depletable base by all persons subsequently acquiring an interest in the property, and that the aggregate depletable bases of all parties in interest must never exceed that unchangeable depletable base represented by the value of the property at March 1, 1913.

In support of this line of argument the Circuit Court of Appeals refers to the apportionment clause at the end of Section 234(a)(9) and the interpretation given to the clause by this Honorable Court in the case of *Lynch* vs. *Alworth-Stephens Co., supra.* It is submitted that the Circuit Court of Appeals has failed to comprehend the real meaning of the apportionment clause and has misapplied the decision of this Honorable Court in *Lynch* vs. *Alworth-Stephens Co., supra.*

In the *Night Hawk Leasing* case, *supra*, the Phelps Dodge Corporation owned a copper property on March 1, 1913, which had a value establishing a depletion unit per pound of 4.11 cents. The appellant in 1919 leased the property from the Phelps Dodge Corporation. The lease provided for a specific royalty payable as copper was removed and provided for no acquisition cost, advance royalty or bonus. In 1922 the Phelps Dodge Corporation and the appellant made an agreement apportioning the 4.11 cents per pound between them, 3 cents a pound to the appellant and 1.11 cents to the lessor, Phelps Dodge Corporation. The Commissioner objected to the allowance of any depletion to the appellant, contending that the appellant had no cost for the lease, did not hold the lease on March 1, 1913, and was not entitled to discovery value. The Court, after quoting a portion of the apportionment clause of the 1921

Act (which is identical in language with that of the 1918 Act herein involved), said, at page 614:

> "Accordingly, if the owner of a claim be entitled under any one of these provisions to a depletion deduction in case the claim be operated by him alone, such deduction shall be equitably apportioned between such owner and lessee if the claim be operated by a lessee. This is the case regardless of whether the lease was acquired by the lessee prior to March 1, 1913, or subsequent to that date without 'acquisition cost, advance royalty, or bonus,' and without discovery by the lessee. The equitable interest of the lessee in the leased mine, upon which the depletion allowance depends, results from the mutual covenants of the parties in the lease. The lessee thereby acquired certain property rights in the mine."

After the above quotation, the Court refers, as does the Circuit Court of Appeals in the instant case, to the decision in *Lynch* vs. *Alworth-Stephens Co., supra.*

Under the statutory provision value at March 1, 1913, is taken "in lieu of cost up to that date." The purpose of this substitution of March 1, 1913 value for cost is plain. That date marked the incidence of the income tax and value at that date was regarded by Congress as representing cost. The apportionment clause relates to the "deductions allowed by this paragraph," one of which is cost and another of which is March 1, 1913 value substituted for cost. It seems clear that to qualify a lessee to share in the apportionment he must have some interest in the thing to be apportioned. He has that interest in March 1, 1913 value, if, and only if, the lease was in existence at that date. The same is true of discovery value. He can have no inter-

est in his lessor's cost arising after February 28, 1913. His interest by way of cost must grow out of his own cost of acquisition—not his lessor's.

This interpretation of the apportionment clause renders even more inescapable the fact that it was meant to apply only to situations in which there were two or more outstanding interests on the basic date. It is unthinkable that Congress could have meant depletion and depreciation deductions to be apportioned on account of every transaction in oil properties. If the broad meaning attributed to the clause by the Circuit Court of Appeals in the instant case and the Court of Appeals of the District of Columbia in the *Night Hawk* case is correct, the Commissioner is required to apportion the depletion and depreciation deductions constantly throughout the life of oil properties as various interests arise and accumulate. It would be necessary for the Commissioner to apportion the taxpayer's interest in the instant case if the taxpayer had purchased the property at March 1, 1913, for $15,710,099.52—if that had been the taxpayer's *cash* cost instead of value at March 1, 1913 of property acquired prior to that date. It would be necessary in the case of all taxpayers acquiring oil properties for cash subsequent to February 28, 1913, and thereafter leasing them. For example, a taxpayer might purchase fee ownership in oil properties in 1920 for a cost of $1,000,000.00 and lease the properties in 1922, with or without a bonus. The Commissioner under the broad meaning of the apportionment clause adopted in the *Night Hawk* decision and expressed in the Circuit Court of Appeals opinion in the instant case would be required to apportion between lessor and lessee this $1,000,000.00 cost to the fee-owner-lessor. In doing so the Commissioner would be say-

ing in effect that the fee-owner-lessor, who had paid $1,000,000.00 cash for the property, was not permitted to recover tax-free this $1,000,000.00 cash paid. This is the same as saying that this capital investment should not be returned as depletion but should be taxed under the guise of income.

The apportionment clause uses the word "equitably." It calls for equitable apportionment. Whatever may be the meaning of this word, it can hardly have been intended to take away from a taxpayer the right to the return tax-free of a cash investment in property subject to depletion. If this is true, it is an equally inequitable apportionment to take away from a taxpayer a part of his capital investment in property at March 1, 1913, which by the statute is substituted for cost, in the case of properties acquired prior to that date.

The word "apportion" should be given no stronger meaning than the word "equitably." The word "equitably" qualifies apportionment. While Congress may have had discretion to allow or not to allow depletion as a deduction, it is hardly conceivable that once it granted the depletion deduction it would have intended to allow taxpayers who themselves operate property the return of their entire capital interest tax-free and to allow other taxpayers who do not themselves operate the property the return tax-free of only part of their investment. This is an inevitable result of apportionment to the lessee where a lease is made after February 28, 1913, or after the acquisition by a lessor for a cash cost. The lessor still has the same interest in the property represented by a remainder interest and the lease; yet by reason of the lease a part of his interest in the property is no longer depletable.

Such an inequitable result could scarcely have been intended. It is far more reasonable to assume that Congress meant to treat all taxpayers similarly situated on an equal basis and that the apportionment clause means what its legislative history and the decision of this Court in *Lynch* vs. *Alworth-Stephens Co., supra,* indicates that it means—that all persons having an interest in property at March 1, 1913, should divide on a fair basis the depletion pertaining to the value at that date.

Doubt as to the meaning of the apportionment clause may be resolved by a reference to the situation confronting Congress when the clause was enacted. The 1916 Act contained no apportionment clause. Prior to the enactment of the 1918 Act it was being urged under the 1916 Act that *lessees* were not entitled to depletion upon the basis of value at March 1, 1913. In Regulations 33 Revised, interpreting the 1916 Act, it was ruled (Article 170) that in the case of an *operating fee owner* the amount returnable through the depletion deduction was the fair market value of the property as of March 1, 1913, and that in the case of a *lessee* the capital to be returned was the amount paid in cash or its equivalent as a bonus or otherwise by the lessee for the lease plus certain additional expenses.* The operating owner was permitted to take depletion on the basis of cost *or March 1, 1913 value,* if greater than cost; the lessee was limited to depletion based on cost, even though the lease was entered into or acquired prior to March 1, 1913, and had a value on that date greater than cost.

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* See also T. D. 2447, unpublished, referred to in Part I, page 524 of Hearings Before Committee on Ways and Means on Revenue Act of 1918.

It needs no discussion to point out the injustice of this differentiation between lessors and lessees. It is obvious that the purpose of the apportionment clause was to correct the differentiation, and to insure depletion to *lessees* on the basis of the value of their leasehold interests at March 1, 1913. The legislative history of the apportionment clause reveals this purpose clearly.*

In the light of subsequent events the evil intended to be cured by the apportionment clause proved imaginery; the decision of this Honorable Court in *Lynch* vs. *Alworth-Stephens Co., supra,* announced after the enactment of the 1918 Act on February 24, 1919, effectively disposed of the Treasury's contentions that *lessees* were not entitled to depletion on the basis of value on March 1, 1913. However, the decision of this Court was not announced when the apportionment clause was first enacted and Congress apparently intended to make the matter doubly clear.

In the light of this legislative history the meaning of the apportionment clause becomes clear. The clause was intended to operate in cases in which there were on March 1, 1913, *both* a lessor and a lessee. This meaning is confirmed by an examination of the facts in the case of *Lynch* vs. *Alworth-Stephens Co., supra.* It is highly important that the leases involved in that case were in existence at March 1, 1913; there was involved no lease entered into after February 28, 1913, as in the instant case.

The question presented in *Lynch* vs. *Alworth-Stephens Co., supra,* was whether lessees were entitled under the 1918

* See Hearings Before Committee on Ways and Means, House of Representatives, on Proposed Revenue Act of 1918, Part I, pages 515-572; Hearings before Senate Finance Committee, 65th Congress, 2nd Session, H. R. 12,863, pages 356-371. See also Hearings Before Committee on Ways and Means, particularly pages 528, 545.

Act to depletion based upon value at March 1, 1913. It was held that where the lease was entered into *prior* to March 1, 1913, and *was in effect on that date* the total interest therein was to be divided between the lessor and lessee and that the value at March 1, 1913, of the *lessee's* interest therein was depletable. The theory adopted was that although the lessee might not have acquired the minerals in place, his privilege was a property right at March 1, 1913, the value of which should be returned to the lessee by the depletion allowance.

Even if this Court should decide that the apportionment clause had application to a situation such as is presented in the instant case in which the lease was entered into after February 28, 1913, there is no reason for giving to the clause an interpretation which deprives anyone of the right to deplete his capital investment in oil properties, whether that capital is represented by cost or value at March 1, 1913. This is clear from the language of the apportionment clause. What is to be apportioned? The statute says "the deductions allowed by this paragraph." The statute does not require the apportionment of only one deduction allowed by the paragraph; it requires the apportionment of all the deductions allowed. In the case of a lease entered into after February 28, 1913, the statute allows a deduction to the lessor based upon value at March 1, 1913, and to the lessee upon the basis of cost. Both of these deductions must be apportioned if the apportionment clause applies to situations in which leases have been entered into after February 28, 1913. If these deductions are to be equitably apportioned, the essential purpose of Congress must be kept in mind and the apportionment must be such that the lessor will secure the return tax-free of the value of his fee inter-

est at March 1, 1913, and the lessee will secure the return tax-free of the cost of his lease entered into after that date. What has to be apportioned is a deduction to the lessor-fee-owner based on the March 1, 1913, value *and* a deduction to the lessee based on its cost—in the instant case the bonus paid by the Standard Oil Company plus all improvement costs.

The vice of the *Night Hawk* decision is thus apparent. The taxpayer in that case had no cost, March 1, 1913 value, or discovery value. It had no deduction allowed by the paragraph. The *Night Hawk* decision requires apportionment to a lessee taxpayer not entitled to any depletion at all of part of the depletion to which its lessor was entitled. The effect of the decision is, therefore, to give to the lessee depletion which the granting clause of the statute does not allow, by taking away from the lessor depletion which the granting clause allows to it. This is not to apportion the "deductions allowed by this paragraph" among persons entitled to depletion; it is to apportion a deduction allowed by the paragraph between a person entitled to depletion *and a person who is entitled to no depletion whatever.*

The error of the Circuit Court of Appeals in the instant case is equally clear and is not essentially different because the lessee did have a cost by virtue of the payment of the bonus. There were two deductions allowed by the statute, one to the lessor, Murphy Oil Company, based upon the March 1, 1913, value, and the other to the lessee, Standard Oil Company, based upon the cash paid in the form of a bonus. The Circuit Court of Appeals construed the apportionment clause as requiring the allowance of deduction based upon the cash cost to the lessee *at the expense of the deduction allowed to the lessor.* This is not to appor-

tion "the deductions allowed by this paragraph." It is to apportion one deduction allowed by the paragraph based upon the March 1, 1913, value of the properties, and to make no apportionment whatever of the other deduction based upon the cost in the hands of the lessee, Standard Oil Company. It is an interpretation of the apportionment clause violating not only the language of the clause itself, which uses the plural in speaking of "deductions"; more seriously, it is a violation of the basic intendment of the section in that it precludes the return tax-free by way of depletion to the lessor of the value of its property at March 1, 1913.

The depletion provision has been described as a statutory recognition of the wasting character of mineral resources and the purpose of the provision is plainly to provide for taxpayers whose income is from natural resources a protection from tax upon capital. This purpose cannot be accomplished unless the taxpayer is enabled to receive tax-free by way of the depletion allowance the cost of its property or its value on March 1, 1913, if it was acquired prior to that date. Anything which prevents the recovery of this capital tax-free will frustrate the manifest purpose of Congress. The meaning attributed to the apportionment clause by the Circuit Court of Appeals in the instant case and the Court of Appeals of the District of Columbia in the *Night Hawk* case, strikes at the heart of this legislative intent. If the meaning is sanctioned, taxpayers owning property at March 1, 1913, who subsequently lease the property will never secure the return tax-free of the value of their interest in the property at March 1, 1913. Indeed, taxpayers who purchase property for cash will never secure the return tax-free of their capital invested in the prop-

erty after February 28, 1913. In the *Night Hawk* case the Phelps Dodge Corporation is obviously deprived of the return tax-free of approximately three-fourths of the value of its properties at March 1, 1913. In the instant case the same is true to the extent to which the bonus is applied in reduction of the taxpayer's capital sum. The reduction is lost to the taxpayer forever as a part of the depletable value of the taxpayer's interest at March 1, 1913, unless the Commissioner is correct in the theory that depletion should be determined on an income basis. The *Night Hawk* decision is completely unsound and cannot be sustained on any theory. It robs the lessor of depletion to which he is plainly entitled and donates that depletion in contravention of the statute to the lessee.

The opinion of the Circuit Court of Appeals in the instant case is equally indefensible. No excuse exists for reducing the capital sum on the theory suggested by it. There remains the theory that the amount of reduction is depletion properly allowable in years previous to the taxable years involved, viz., depletion allocated to the bonus years. Any attempted justification on this theory fails, however, for the reasons indicated under Point II and the decision of the Circuit Court of Appeals is therefore left wholly without support on principle or authority.

If the apportionment clause is to be held applicable in cases in which the lease of depletable properties is entered into after February 28, 1913, it follows that the depreciation of improvements allowance as well as the depletion allowance is subject to apportionment. Both allowances are granted by the paragraph and there is no basis for treating the one allowance differently from the other. In the instant case this would mean the apportionment not only

of the established value at March 1, 1913, but also of the cost of the lease to the Standard Oil Company represented by the bonus. It means also that there is subject to apportionment between the petitioner and the Standard Oil Company a deduction for depreciation based upon the cost of all improvements made by the Standard Oil Company upon the premises. This logical development of the application of the apportionment clause in cases in which the lease was entered into after February 28, 1913, shows the fallacy of any such application of the clause. However, if this interpretation is correct, the petitioner has obviously not received the deductions to which it is entitled and the case should be remanded in order that a proper apportionment may be made.

POINT IV.

The Commissioner's amended regulation is arbitrary, capricious and invalid.

(a)

Impossibility of Proving Royalties Expected to be Received.

Ordinarily it is not difficult to adduce proof of the fair market value of real property, whether that property be a city lot, a farm or mineral lands. Scientific methods have been devised which make it relatively easy to estimate with reasonable accuracy the number of barrels of oil which a given property will produce. These two factors—value and reserves—together with the production for the taxable period, are all that are necessary for the determination of depletion according to the unit-of-production method which

has been discussed. But to determine depletion attributable to a bonus by the method prescribed in Article 215 of Regulations 45, as amended, makes it necessary to introduce still another factor which the lower court describes in its opinion as (R. II-291) "* * * proof of the probable market value of the oil to be marketed under the lease in terms of dollars per barrel * * *." The lease herein involved, like most oil leases, did not provide for a fixed cash royalty per barrel, but leaves the royalties to be paid subject to the price of oil current at the time of production. There is accordingly no escape from the necessity of estimating the future price of oil in determining the royalties expected to be received.

The amended regulation requires in this respect proof of that which is not susceptible of proof. The "probable" market value of the oil to be marketed under the lease in terms of dollars per barrel is dependent upon the production and consumption of oil throughout the term of the lease, not only on the lease in question but throughout the whole world. The price of oil in terms of dollars per barrel necessarily fluctuates from time to time in accordance with supply and demand. Proof of this "probable market value" is so remote and speculative as not to be admissible in evidence. As illustrative of the impossibility of proof let us suppose that today one wished to establish the amount of royalties "in terms of dollars per barrel" expected to be received under the remaining term of the lease. It cannot be assumed that the present absurdly low price of oil will remain constant over the remaining term of the lease. It is an accepted fact that the price of oil, as the price of all other products, is always fluctuating. There is every reason to expect that in the future the price of oil will fluc-

tuate as it has in the past. Therefore, in estimating the amount of royalty expressed in dollars per barrel to be received during the remaining term of the lease the price now prevalent cannot be used. If today's price of oil cannot be used in estimating the expected royalties in dollars per barrel, what price then can be used? The regulation which has been approved by the lower court specifically requires that the anticipated net market price of oil be determined. Certainly no witness can be found who would be qualified and willing to testify to the future market price of oil to supply that factor essential in the formula approved by the Circuit Court of Appeals.

While it is possible to estimate the number of barrels of oil which a given group of wells will ultimately produce from a given sand or zone, their monthly production may be, and in a great many cases is, restricted because of a surplus in the world's visible supply of oil. That is the condition which exists today and is a matter of common knowledge. We know what the price of oil is today and we know the daily production of our wells, but we do not know when the world's visible supply of oil will be increased or decreased to such an extent that the price of oil will be decreased or increased. Fluctuation in the price of oil is caused by many factors other than increase in the supply. Demand, equally with supply, determines market price. The elements affecting demand are as numerous as the products which compete with oil, and as complex in their operation as our economic system itself. The discovery of a new fuel may make oil as antiquated as tallow candles; on the other hand, the development of new machines for transportation may enormously expand the oil market. Such a growth actually happened after this

lease was made—the tremendous increase in the use of automobiles. Similarly general changes in the value of money produce cyclical price fluctuations, blows which our economic system is repeatedly called upon to endure.*

From these observations, it is clear that it is impossible to prove even approximately or within a reasonable range the amount of money which will be received for each barrel of royalty oil at the time it is actually produced. It being impossible to determine this most essential factor, the formula as prescribed by the regulations and approved by the lower court is useless in determining the amount, if any, of depletion attributable to a bonus. That taxation is a practical matter is universally recognized by the courts. The law never requires impossibilities. Therefore, this regulation in requiring impossibilities is so arbitrary and capricious as to be invalid.

(b)

Differentiation Between Depletion in Bonus and Non-Bonus Cases.

The amended regulation is arbitrary, capricious and therefore invalid for the further reason that it is so wanting in a basis for classification as to produce a gross and patent inequality between lessors who receive a bonus and lessors who do not receive a bonus. The amended regulation places the computation of a lessor's depletion where a bonus is paid upon a money basis, while in the case of a lease with no bonus the production or exhaustion basis is prescribed by Article 214 of Regulations 45, which specifically requires the annual depletion deductions in non-

* See quotation from *Burnet* vs. *Logan, supra,* footnote *, page 30, *supra.*

bonus cases to be based upon the exhaustion of the mineral reserves. Amended Article 215 (a), however, requires depletion to be taken in respect of the bonus and further provides that the remainder of the depletable base is to be recovered "through depletion deductions *on the basis of royalties thereafter received,*" *i. e.,* on the basis of money thereafter received and not on the basis of the units of mineral thereafter produced.

(c)

Requirement that Excess Depletion be Returned as Income in Event of Termination of a Lease.

Paragraph (d) of Article 215 of Regulations 45, as amended by T. D. 3938, *supra,* is a supplement to paragraph (a) thereof and is necessary in the Commissioner's view to make the article workable. For the convenience of the Court this sub-paragraph will again be quoted in full:

> "Upon the expiration, termination, or abandonment of the lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account the excess of the depletion theretofore allowable in respect of the bonus and royalty payments over the actual depletion or loss in value sustained as a result of the operations under the lease, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned."

In paragraph (a) of Article 215, as amended, the Commissioner requires that the depletion be taken upon a cash receipts bases. He then requires under the provisions of paragraph (d) of the Article that the cash receipts basis of computing depletion provided for in para-

graph (a) shall be checked by reference to the actual depletion as a result of the operations under the lease. If it is found upon this check that the depletion theretofore taken was excessive it is to be restored to capital account and returned as income to the extent of the excess. It is quite apparent that the Commissioner recognizes but one correct method of computing depletion, that is, by reference to the exhaustion of the resources.

The principal point, however, to which attention is directed is the Commissioner's requirement that excess depletion of prior years be restored to income *in the year in which the lease expires, terminates, or is abandoned.* This requirement cannot be enforced for the fundamental reason that it is not within the Commissioner's power to define income. Income must be received or derived before even Congress has the power to levy a tax thereon without apportionment.* Whether the expiration, termination or abandonment of a lease produces income to the lessor is determined, not by reference to depletion deductions taken in years prior thereto, but solely by reference to the facts involved in connection with the expiration, termination, or abandonment of the lease. If he has received money or some property right of value in connection with the termination of the lease, then and then only can he be said to have had income taxable under the provisions of the Sixteenth Amendment to the Constitution and the revenue act in effect in the year of termination.

Paragraph (d) has been held invalid for the reasons given (*Kittie A. Knapp,* 7 B. T. A. 790; A. T. Cooper, 7 B. T. A. 798).

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* *Brushaber* vs. *Union Pac. R. R. Co.,* 240 U. S. 1.

Conclusion.

The regulation is therefore invalid for three reasons:

(a) It requires the proof of a fact which is not susceptible to proof; (*i. e.*, "royalties expected to be received under the lease");

(b) It is unreasonable in classification in that it requires a computation of depletion in bonus cases different from that required in non-bonus cases, *i. e.*, dollars versus units of production; and

(c) It attempts to tax as income that which is not income under the Constitution or any revenue act yet enacted by Congress.

POINT V.

The history of Article 215, as amended, of Regulations 45 and the time of its injection into this case puts upon the Commissioner the burden of pleading and proving the allocation contended for by him.

A short history of the depletion provisions of the various Revenue Acts and the regulations and rulings promulgated by the Commissioner in interpretation of the statutes is of interest in that it demonstrates the vacillation of the Commissioner in the face of a steady policy of Congress.

The Corporation Tax Law of 1909 contained no provision for a deduction on account of depletion. It was held in *Stratton's Independence, Limited* vs. *Howbert, supra,* that the Constitution did not make it imperative that there be such an allowance.

However, the Congress was convinced that fairness required that a depletion deduction be permitted. Conse-

quently a depletion allowance was granted by the Revenue Act of 1913, and depletion deductions have been authorized by every subsequent act.*

The regulations did not treat bonuses separately until Regulations 45, 1920 edition, were promulgated January, 1921. Article 215 provided that bonus payments should be regarded as a return of capital to the lessor.**

This was directly contrary to earlier rulings of the Commissioner to the effect that bonuses were income and that no depletion deductions were allowable in respect thereof.

Again the Commissioner changed his mind. On November 13, 1926, he ruled that a bonus was income, subject, however, to a depletion deduction. Treasury Decision 3938, *supra.****

The first shift of position might well raise the suspicion of error when it is recalled that the Sixteenth Amendment remained unchanged and the statutory policy was constant.

The character of the bonus—capital or income—must also have remained the same. Either one position or the other was incorrect. The suspicion of error ripens into certainty with the second change of view on the part of the Commissioner, for the immutability of the governing factors still exists, and in addition there is injected the uncertainty of "expected royalties." It is clear that a regu-

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* Subdivisions B and G(b), Section II, Revenue Act of 1913 (38 Stat. 114, 166); Section 5, Paragraph Eighth (a) and Section 12 (a), Paragraph Second (a), Part I, Title I, Revenue Act of 1916 (39 Stat. 756). The provision of the 1916 Act was adopted by the Revenue Act of 1917, Section 212 (40 Stat. 300). Sections 214 (a) (9) and 234 (a) (9), Revenue Act of 1918 (40 Stat. 1057). Similar allowances are granted by the later Revenue Acts applicable to years subsequent to those here involved.

** See page 7, *supra*.

*** The amended regulation is quoted in full, *supra*, page 8.

lation is entitled to little respect, unless it has been uniform, general, long-continued and reasonable.*

It was stated above that the last amendment of Article 215 was announced on November 13, 1926. It was not, however, until after the hearing of this case before the Board of Tax Appeals that the Commissioner adapted to this case the theories of his new creation, by applying the amended regulation to his brief, thus completely changing the issues.

The sole question presented to the Board on the record was whether or not the bonus payments in their entirety constituted a return of capital or income. That was the proposition upon which issue was joined and the case tried before the Board. By relying upon Article 215 as amended, the Commissioner has injected new concepts into the case.

It is recognized, of course, that the taxpayer has the burden of showing that the determination of the Commissioner (as shown in the sixty-day letter from which the appeal is taken) is in error, but this rule does not place the burden of proof upon the taxpayer to meet new propositions advanced by the Commissioner after the hearing. The Commissioner is an ordinary litigant subject to the rules of procedure which govern the conduct of suits and which, after all, are only aimed at common fairness. If he desires to propose new issues after the close of the proofs he is required to do so by appropriate pleading and the burden of proof is upon him to establish the allegations made therein. The Board of Tax Appeals held that the determination of the Commissioner as shown in his sixty-day letter, which is the basis of the appeal, was erroneous. It

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* *Iselin* vs. *United States*, 270 U. S. 245; *Robinson* vs. *Lundrigan*, 227 U. S. 173.

would, therefore, logically follow that the decision of this Court should be in favor of the taxpayer.

The lower court, in its opinion, stated that (R. II-291):

> "* * * the Commissioner correctly determined that at least a part, if not all, of the bonus payment is to be treated as return of capital. The burden is on the taxpayer to show that the computation of tax by the Commissioner is erroneous, and there is a failure of proof in this case sufficient to permit allocating a part of the bonus payment to return of capital and part to income, under the above quoted regulation * * *."

The burden of proof does not extend beyond the scope of the hypotheses upon which the deficiency is asserted.

The amendment of Article 215 was not made until after the Commissioner had made his determination contained in the sixty-day letter. If the Commissioner intended to rely upon Article 215, as amended, he should have amended his pleadings before the Board and pleaded the postulate he now relies upon.

Any defense to the appeal of Murphy Oil Company by way of a new theory which the Commissioner desired to interpose should have been raised by affirmative allegations and supported by proof. The duty was upon him to do so.

Rule 14 of the rules of practice before the United States Board of Tax Appeals relative to the answer of the Commissioner provides (italics ours):

> "* * * The answer shall be so drawn as fully and completely to advise the petitioner and the Board of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and *a statement* of

any facts upon which the Commissioner relies for defense or for affirmative relief * * *."

Rule 30 provides:

"The burden of proof shall be upon the petitioner, except as otherwise provided by statute and except that in respect of any new material pleaded in his answer, it shall be upon the respondent."

It is respectfully submitted that since the Commissioner failed to amend his pleadings in such a manner as to allege and prove the new issue injected into the case by his brief, the decision of the Board for that additional reason should be sustained.

Respectfully submitted,

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No. 80

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, NINTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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IN THE

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ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, NINTH CIRCUIT

REPLY BRIEF FOR PETITIONER

The brief of the respondent injected several new and affirmative matters into this case which could not be adequately refuted within the limited time of oral argument. In view of the fact that petitioner received respondent's brief less than a week prior to the argument, petitioner respectfully prays that this Court will permit this brief to be filed and considered.

The affirmative matter demanding refutation divides into two categories.

I—HISTORY OF TAX PAYMENTS

The respondent went off the record before this Court in order to color the case in a manner prejudicial to petitioner. We refer to page 5 of respondent's brief where the unwarranted assertion is made that in the absence of proof it may be assumed that petitioner did not pay any income tax on the bonus. If the subject is open to inference, the presumption is certainly the other way—that a tax was paid if required by law. As a matter of fact any proof offered on this point would properly have been held inadmissible. Actually, the whole subject is immaterial in the instant case, but respondent's assertions demand answer because of respondent's position that the petitioner is making an "opportunistic" argument. Appendix C of respondent's brief, and the statement of respondent's counsel at the argument served to correct to some extent the prejudicial assertions in respondent's brief, but the only method of complete clarification is to outline the taxation history of the petitioner:

Originally, petitioner returned the bonus as income for 1913 to the extent of $1,108,600.97, being the payment received in 1913 less an amount assigned to the transfer of personal property. An audit by the government in 1915 resulted in $1,446,637.19 additional net income on account of the bonus, the theory of this audit was that the bonus was selling price and that there should be offset against it the value of the property at January 1, 1909 (Regulations 33, dated January 5, 1914, released for publication February 12, 1914, Articles 107, 108, 109, 110 and 111. See also Treasury Decisions 2005, 2090 and 2137). The tax paid on account of the bonus in both years was $25,562.38. It was then realized that the petitioner being on an accrual basis, the whole bonus should be income in 1913. In 1920 $25,238.20 additional tax on this theory was assessed, but no demand being made, was never paid.

For the year 1918, petitioner paid a tax of $164,000.00 due entirely to respondent's changed treatment of the bonus, lowering the depletion allowance.

If petitioner prevails in this case, it has underpaid its 1913 tax about $28,000.00 but overpaid its 1918 tax $164,000.00.

If respondent prevails, the 1918 tax is correct, but petitioner would have overpaid its 1913 tax by $23,096.14.

The inference sought to be drawn by respondent is that petitioner somehow escaped income tax on the bonus, and now that the statute of limitations has run against a tax thereon on the theory that it is income, petitioner seeks to treat the bonus as income.

The above history shows conclusively that the petitioner has not been an inequitable, crafty, opportunistic seizer of technicalities, but that it simply endeavored to pay its taxes as the law required. Respondent's several changes in theory in respect to the taxation of bonuses, leaves the petitioner in the unenviable position of being out of pocket even if successful in the present litigation.

We grant that the above facts do not appear in the record. Neither do the corresponding assertions in the respondent's brief. We feel that it is only fair to the petitioner to follow up the respondent's discussion of an immaterial issue with all the facts in regard thereto.

II—REENACTMENT OF REGULATIONS

On page 12 of his brief, respondent argues that the depletion clause having been reenacted without change during a thirteen year period in which the Regulations provided for depletion regardless of extraction, Congress must be taken to have approved the Regulations.

This is a different note from that sounded by respondent in the brief in which he, in conjunction with petitioner, sought the writ of certiorari to review the instant case:

"The proper treatment of cash bonuses paid to lessors of mining properties presents a problem of administration that has resulted in considerable confusion and inconsistent practice within the Treasury Department. * * *

"Prior to its amendment in 1926, the Commissioner applied the rule of the original regulation to a large number of cases, but we are informed that subsequently, so far as possible, the Commissioner modified his treatment of these cases, and by agreement or otherwise applied to them either the rule announced by the Board or that stated in the amended regulation. While it is likely, therefore, that no cases are now pending in which the Commissioner is insisting on the application of the original regulation, we are informed that there are a large number of cases now pending in which the Commissioner has attempted to treat a bonus either as partially income and partially a return of capital (following the amended regulations) or as entirely income (following the decision of the Board in this case). We are also informed that since the decision of the court below, which seems to sustain the amended regulation, the Commissioner, so far as possible, has held all cases in abeyance, pending a possible decision by this Court in the present case so as to avoid further uncertainty and confusion in administration.

"It is therefore important that this Court resolve all doubts with respect to the proper method of handling cash bonuses in cases of this kind and establish a rule which will serve to guide both taxpayers and the Treasury Department in cases to arise in the future and to permit uniform disposition of pending cases." (Pages 4 and 5, Respondent's brief on petition for certiorari.)

Moreover the claim now made is not in accord with the facts. The first time respondent claimed the bonus was other than income was in 1921. Respondent then asserted that it was capital (Reg. 45, Art. 215). Respondent now

argues that this was perfectly consistent with the amendment of the above regulation in 1926. Actually the 1921 regulation was on a sale theory, and did not even purport to be depletion. Another radical shift in 1926 was the introduction of the formula involving royalties expected to be received. The difference between these theories which is so lightly passed over by the government means thousands of dollars to taxpayers, and the difference in result is proof of inconsistency of the Treasury Department.

Actually only two Revenue Acts have been adopted since the amended regulation went into effect—the 1928 and 1932 Acts. The 1921, 1924 and 1926 Acts were enacted while the original regulation was in effect and before the amended regulation went into effect and may be said, by reason of the argument based on legislative approval, to have constituted an approval of the regulation. Consequently this argument by reference to legislative re-enactment is of no value.

The cases cited by respondent do establish the principle that in some circumstances reenactment indicates Congressional approval, but the governing facts of the leading case are so different from those of the case at bar as to actually make it an authority against legislative approval in the instant case. We refer to *National Lead Company* vs. *U. S.*, 252 U. S. 140. There the regulation in question had been *constantly* employed for forty years, and Congress had reenacted the statute four times during that period.

Similar elements of consistency of practice, ambiguous statutes and repeated reenactments, making the other cases cited by respondent much stronger for the theory of legislative approval than the case at bar are readily apparent.

The respondent relies upon the earlier (1919) promulgation of the regulation allowing depletion on minimum royalties. To avoid collateral issues we shall not pause over distinctions between minimum royalties and bonuses which readily suggest themselves. It suffices to say that, assuming the two regulations are alike in disregarding extraction as the measure of depletion, and granting that Congress has approved the minimum royalties regulation, it is a complete *non sequitur* that Congress likewise approved a different regulation which had been subject to change. The Congressional approval is based not upon the common element of disregard of extraction, but upon the element of consistent, well-established rules, which is not present in the bonus regulation.

III—CONSTRUCTION OF THE PHRASE "SUCH REASONABLE ALLOWANCE IN ALL THE ABOVE CASES TO BE MADE UNDER RULES AND REGULATIONS TO BE PRESCRIBED BY THE COMMISSIONER WITH THE APPROVAL OF THE SECRETARY."

It is respectfully suggested to the Court that the above phrase is similar to the phrase used in Section 240 of the Revenue Act of 1918. That phrase has been construed in *Temptor Corn and Fruit Products Co.*, 299 Fed. 326, affirmed *Schlafly v. U. S.* 4 Fed. (2d) 195, C.C.A. 8th (1925) in which it was held that the Commissioner had no authority to make regulations limiting affiliations to cases in which there was ownership or control of 95% or more of the outstanding stock. The Court said:

> " * * * But the question of the fact of affiliation is left by the very definition of what constitutes affiliation, even in the statute itself, a matter of judicial construction, and not a matter of administrative or departmental regulation. * * * So it is too obvious for

argument that it is not left to the Commissioner to prescribe what constitutes affiliation, for the statute fixes that, but what is left to be prescribed by the Commissioner's regulation is the manner of the making of the return."

The principle enunciated in the *Temptor* case was followed in other cases. *News Pub. Co. v. Blair,* 29 Fed. (2d) 955 (App. D.C.) (1928); *Lafayette-South Side Bank v. Commissioner,* 33 Fed. (2d) 646 (App. D.C.) (1929).

The following sections of the Revenue Acts provide specifically for the making of rules and regulations by the Commissioner:*

1918 Act	1921 Act	1924 Act	1926 Act	1928 Act	1932 Act
		203(b)(5)	203(b)(5)	112(f)	112(f)
		204(a)(9)	204(a)(9)	113(a)(9)	113(a)(9)
203	203	205	205	22(c)	22(c)
204(b)and (c)	204(b)and (c)	206(b)and (h)	206(b)and (g)	117(b)— 169— 187	117(b)— 169— 187
	206 (c)	208(e)	208(e)	168	168
		209(c)	209(c)	185	185
213(b)(7)(a)	213(b)(7)(a)	213(b)(7)(a)	213(b)(7)(a)	116(d)(1)	116(d)(1)
214(a)(10)	214(a)(10)	214(a)(9)	214(a)(9)	23(l)	23(l)
	214(a)(11)	214(a)(10)	214(a)(10)	23(n)	23(n)
214(b)	214(b)	214(b)	214(b)	213(a)	213(a)
	217(e)	217(e)	217(e)	119(e)	119(e)
		217(g)(2)	217(g)(2)	215(b)	215(b)
225	225(b)	225(b)	225(b)	142(b)	142(b)
		226(d)	226(d)	47(d)	47(d)
234 (b)	234(b)	234(b)	234(b)	232	232
	238(e)	238(e)	238(e)	131(f)	131(f)
240 (a)	240(a)	240(a)	240(a)	141(b)	141(b)
255	255	255	255	150	149
256	256	256	256	148(a)	147(a)
250 (g)	250(g)	282(b)	285(b)	147(b)	146(b)

* And see Magil, Finality of Determinations of the Commissioner of Internal Revenue, 28 Col. L. R. 563 at 564 and 30 Col. L. R. 147.

IV—CONSTRUCTION OF THE PHRASE "ACCORDING TO THE PECULIAR CONDITIONS IN EACH CASE."

It is respectfully urged upon this court that the word "case" as used in the above quotation is used in the same sense as used immediately previously in the same statutory provision and means the several cases therein cited, viz., mines, oil and gas wells, other natural deposits, and timber. This phrase does not justify the treatment in a peculiar or a different manner of taxpayers receiving a bonus.

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No. 80

In the Supreme Court of the United States

OCTOBER TERM, 1931

MURPHY OIL COMPANY, A CORPORATION, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 955

MURPHY OIL COMPANY, A CORPORATION, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the instant petition.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 231–247) is reported in 15 B. T. A. 1195.

The opinion of the Circuit Court of Appeals (R. 268–295) is reported in 55 F. (2d) 17.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 11, 1932. (R. 297.) Petition for rehearing was denied February 23, 1932. (R. 297.) The petition for certiorari was filed

May 16, 1932. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Section 214 (a) (10) of the Revenue Act of 1918 permits a reasonable deduction for depletion in the case of mineral property. Petitioner, a lessor of mineral property, received between 1913 and 1918 a cash bonus as part consideration for the lease. The question is whether that bonus may be treated as in part a return of capital for the purpose of computing petitioner's depletion deductions in calculating petitioner's income and excess-profits taxes for the years 1919 and 1920.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix, pp. 7–11, *infra*.

STATEMENT

This was a petition to the Circuit Court of Appeals for the Ninth Circuit to review an order of the Board of Tax Appeals which held that the respondent had erred in determining a deficiency of $398,400.53 in petitioner's income and excess-profits tax for the years 1919 and 1920. The relevant facts as found by the Board are in substance as follows (R. 234, 237–240):

Petitioner, a California corporation, acquired certain oil properties before March 1, 1913. On December 1, 1913, petitioner leased the properties to

the Standard Oil Company of California for forty years. The lessee paid petitioner during the years 1913 to 1918, inclusive, a cash bonus amounting to $5,173,595.18, in addition to the regular royalties stipulated in the lease.

Acting under Article 215 of Treasury Regulations 45 (*infra,* p. 8), the respondent treated the bonus as a return of capital and therefore reduced by the amount of the bonus the basic value ("depletable base") of petitioner's oil rights, which petitioner was entitled to recover through depletion allowances. This action resulted in a reduction in the amount of depletion deduction allowed to petitioner for the years 1919 and 1920, with a corresponding increase in income and excess profits taxes for those years. (R. 12–23.)

Petitioner appealed to the Board of Tax Appeals (R. 25–36.) Before the trial, Article 215 was amended by T. D. 3938, C. B. V–2, pp. 117–118, *infra,* p. 9. After the trial but before the case was decided by the Board, the Commissioner filed a brief (quoted in part in the opinion of the Board, R. 244–245) admitting error in that he had failed to apply the amended regulation, but urging that his computation should be sustained because of the failure of petitioner to bring itself within the amended regulation by proof of the amount of royalties expected to be received during the life of the lease.

The Board held that the Commissioner's computation was erroneous, that the amended regulation

was invalid, and that the bonus was income in its entirety. (R. 231–247.) The court below reversed the Board, holding that a part, if not all, of the bonus constituted a return of capital and that as the petitioner had failed to show a basis for allocation between income and capital, the Commissioner's determination should have been sustained. (R. 268–295.)

DISCUSSION

The proper treatment of cash bonuses paid to lessors of mining properties presents a problem of administration that has resulted in considerable confusion and inconsistent practice within the Treasury Department. By Article 215 of Treasury Regulations 45 (1920 edition, *infra,* p. 8), a cash bonus was treated as a return of capital. In 1926 Article 215 was amended by T. D. 3938, C. B. V–2, pp. 117–118 (*infra,* pp. 9–11), which treated a cash bonus as in part a return of capital, the proportion that was such to be determined in accordance with a stated formula. This regulation was applied by the Commissioner in cases arising between the time of its adoption and the decision of the Board in this case. Many such cases are now pending. The Board in the present case held the amended regulation invalid. It ruled that a bonus is income in its entirety and that no part of it represents a return of capital. The Board also inferentially rejected the principle of the original regulation. The Commis-

sioner has followed the Board decision in a number of cases which are also now pending.

Prior to its amendment in 1926, the Commissioner applied the rule of the original regulation to a large number of cases, but we are informed that subsequently, so far as possible, the Commissioner modified his treatment of these cases, and by agreement or otherwise applied to them either the rule announced by the Board or that stated in the amended regulation. While it is likely, therefore, that no cases are now pending in which the Commissioner is insisting on the application of the original regulation, we are informed that there are a large number of cases now pending in which the Commissioner has attempted to treat a bonus either as partially income and partially a return of capital (following the amended regulation) or as entirely income (following the decision of the Board in this case). We are also informed that since the decision of the court below, which seems to sustain the amended regulation, the Commissioner, so far as possible, has held all cases in abeyance, pending a possible decision by this Court in the present case so as to avoid further uncertainty and confusion in administration.

It is therefore important that this Court resolve all doubts with respect to the proper method of handling cash bonuses in cases of this kind and establish a rule which will serve to guide both taxpayers and the Treasuy Department in cases to

arise in the future and to permit uniform disposition of pending cases.

The question involved is of general importance. We are informed by the General Counsel of the Bureau of Internal Revenue that the question presented affects from 2,000 to 5,000 or more cases involving taxes amounting to from $18,000,000 to $25,000,000, which have arisen within the last three years. The question would also seem to be involved in every mining lease under which a bonus or minimum royalty is paid. It will undoubtedly arise frequently in the future, not only under the Revenue Act of 1918 but under all of the later Acts. The amount involved in the instant case is large.

In view of the confused state of the law and of the importance of the question, we do not oppose the petition.

Respectfully submitted.

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MAY, 1932.

APPENDIX

Revenue Acts of 1918, c. 18, 40 Stat. 1057, 1066, 1067:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *.

Treasury Regulations 45 (1920 Edition):

ART. 215. *Depletion—Adjustments of accounts based on bonus or advanced royalty.*—(a) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition.

(b) Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year

on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If, for any reason, any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed, and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is terminated or the property repossessed, and the tax thereon paid.

(d) Upon the expiration, termination, or abandonment of a lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account so much of the bonus received and deducted from capital recoverable through depletion as is in excess of the actual depletion or loss in value sustained as a result of the operations under the lease and the corresponding amount will be income for the year in which the lease expires, terminates, or is abandoned.

Article 215 of Regulations 62 and Article 216 of Regulations 65 are substantially the same.

T. D. 3938, C. B. V–2, pp. 117–118:

Article 215 of Regulations 45 (1920 edition), article 215 of Regulations 62, and article 216 of Regulations 65 are hereby amended to read as follows:

ART. 216 (215). *Depletion—Adjustments of accounts based on bonus or advanced roy-*

alty.—(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.

(b) Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed,

and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is terminated or the property repossessed, and the tax thereon paid.

(d) Upon the expiration, termination, or abandonment of the lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account the excess of the depletion theretofore allowable in respect of the bonus and royalty payments over the actual depletion or loss in value sustained as a result of the operations under the lease, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

All rulings inconsistent herewith are hereby revoked.

This Treasury Decision appears as Article 216 of Regulations 69 and Article 236 of Regulations 74.

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No. 80

In the Supreme Court of the United States

OCTOBER TERM, 1932

MURPHY OIL COMPANY, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 231–247)[1] is reported in 15 B. T. A. 1195. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 268–295) is reported in 55 F. (2d) 17.

[1] Both the taxpayer and the Commissioner sought review of the Board's decision. Separate petitions were filed, but the cases were heard together by the Circuit Court of Appeals and disposed of in one opinion. While the records in both cases have been printed in this Court, all references in this brief are to the second record, which was No. 6459 in the court below.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 11, 1932. (R. 296.) A petition for rehearing was denied February 23, 1932. (R. 297.) The petition for certiorari was filed May 16, 1932, and was granted May 31, 1932. (R. 304.) The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Article 215 (a) of Treasury Regulations 45 (as amended by T. D. 3938, *infra,* p. 31), promulgated pursuant to Section 234 (a) (9) of the Revenue Act of 1918 (*infra,* p. 27), provides that where a lessor of oil property receives a bonus in addition to royalties a depletion deduction shall be allowed with respect to the bonus in a specified proportion. Is this Regulation valid?

2. Before T. D. 3938, *supra,* Article 215 (a) (*infra,* p. 29) provided that a bonus paid to a lessor of oil property in addition to royalties should be considered as a return of capital and deducted from the capital sum recoverable through depletion. If the amended Regulation is invalid, was the original Regulation valid?

3. Petitioner in the present case leased its oil properties in return for bonus payments and royalties. The Commissioner, applying the original

Regulation, deducted the sum of the bonus payments from the amount recoverable by petitioner as depletion. This resulted in a reduction of the depletable base for 1919 and 1920, and the Commissioner accordingly determined deficiencies for those years, from which petitioner appealed to the Board of Tax Appeals. The Regulation was amended before the hearing in the Board, but petitioner did not produce any evidence to bring itself within the amended Regulation. The decision of the Board that the amended and original Regulations were invalid and that the bonus payments were entirely income was reversed by the Circuit Court of Appeals, which held the amended Regulation valid. Was it error for the Circuit Court of Appeals under the circumstances of this case to refuse to remand the case to the Board to permit petitioner to bring itself within the amended Regulation by further proof?

STATUTES AND OTHER AUTHORITIES INVOLVED

These are set forth in Appendix A, *infra,* pp. 27–33.

STATEMENT

This was a petition to the Circuit Court of Appeals for the Ninth Circuit to review an order of the Board of Tax Appeals which held that the respondent had erred in determining a deficiency of $398,400.53 in petitioner's income and excess-

profits taxes for the years 1919 and 1920. The parties filed a brief stipulation of facts in the Board (R. 53–56), to which was appended a number of exhibits, of which only Exhibit F (R. 179–224) is material here. The Board's findings of fact (R. 234–240) are meagre, and a complete statement of the case requires reference to other portions of the record.

Petitioner, a California corporation, acquired the Whittier and Coyote oil properties before March 1, 1913 (R. 234), and leased them to the Standard Oil Co. of California on December 1, 1913, for 40 years (R. 237, 179–224). The lease called for a royalty of one-fourth of the oil produced, and in addition cash payments to petitioner of $4,000,000, payable in installments on specified dates between 1914 and 1918, which were not dependent on production. (R. 238, 181.) Petitioner also received a down payment of $1,500,000 in 1913. (R. 238.) The Commissioner determined that portions of these payments were consideration for the transfer of fixtures, machinery, and equipment, etc., and that the remainder of $5,173,595.18 was a bonus payment for the lease. Of this remainder he allocated $4,517,402.70 to the Coyote property and $656,192.48 to Whittier. (R. 239.)

It does not appear whether petitioner reported the bonus payments as income in the years when

received nor whether petitioner paid any income taxes with respect to such sums in those years.[2] Petitioner's books showed net income of $910,609.09 for 1919 (R. 14) and $2,881,680.14 for 1920 (R. 16).[3] Nevertheless petitioner's income and excess-profits tax returns for those years apparently showed that no tax was owing. (R. 16, 18, 250.) For the year 1919 this result was due in part to a claimed deduction of over $1,370,000 for legal expenses in and the cost of settlement of a suit with respect to the oil lands. (R. 14.) It does not appear what method of calculation was used to produce the same result for the year 1920.

On April 24, 1926, petitioner took an appeal from the Commissioner's determination to the Board of Tax Appeals. (R. 6.) In its second amended petition, filed September 21, 1928 (R. 38), petitioner urged that the Commissioner had erred in treating the bonuses as a return of capital.[4] On

[2] While under these circumstances it may be assumed that petitioner paid no income taxes on the bonuses when received, the burden having rested on it to show the contrary, we have been informed by the Treasury Department that no such taxes were in fact paid except for 1913, and a part of that year's payment was refunded.

[3] The Commissioner's calculation of petitioner's net income for 1919 and 1920, subject to depletion deductions, was $2,636,882.78 and $2,988,550.51, respectively. (R. 14, 16, 269.)

[4] Petitioner also contended that the Commissioner should have permitted it to deduct the sum of over $1,370,000, made up of legal expenses and the cost of settlement of a suit. This contention was rejected by both the Board of Tax Appeals (R. 240–243) and the Circuit Court of Appeals

November 13, 1926, Article 215 (a) of Regulations 45 had been amended by T. D. 3938, V-2, C. B. 117, to provide that where a lessor receives a bonus in addition to royalties a depletion deduction shall be allowed in respect of the bonus in an amount equal to that proportion of the March 1, 1913, value which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received (*infra,* p. 31). After the hearing before the Board the Commissioner filed a brief (quoted in part in the opinion of the Board at R. 244) admitting that he had erred in failing to apply the amended Regulation, but urging that his computation should be sustained because of petitioner's failure to bring itself within the amended Regulation by proof of the amount of royalties expected to be received during the life of the lease.

The Board (four members dissenting and one taking no part) held that the bonus was entirely income and that no depletion allowance was permissible with respect to it. It expressly held the

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(R. 291–295), and is not now being urged by petitioner. In the Board it was also argued that the Commissioner had erred in deducting the full amount of depletion for the years 1913 to 1915 instead of such sums only as petitioner was entitled to deduct as depletion for those years under the Income Tax section of the Tariff Act of 1913. The Board of Tax Appeals disposed of this contention by a reference to *Thompson Oil & Gas Co.* v. *Commissioner*, 15 B. T. A. 993, and of course this question is no longer open since the decision of this Court in *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301.

amended Regulation invalid and inferentially held the original Regulation invalid also. (R. 240–247.) The Board entered a decision that there were no deficiencies (R. 253). The Circuit Court of Appeals held the amended Regulation valid and reversed the Board, but it declined to remand the case to permit petitioner to bring itself within the amended Regulation by further proof, and therefore affirmed the determination of the Commissioner. (R. 268–295.) A petition for rehearing was denied. (R. 297.)

SUMMARY OF ARGUMENT

The Revenue Act of 1918 provides that in computing net income there shall be allowed as a deduction in the case of oil wells a reasonable allowance for depletion, according to the peculiar conditions of each case, under Regulations of the Treasury Department. The Treasury Regulations provide that where a lessor of oil properties receives a bonus in addition to royalties, the bonus shall be returned as gross income and a depletion allowance made against it in specified proportion. The sole question in this case is one of statutory construction; that is, whether the Commissioner is restricted, in administering this statute, to making depletion deductions only in connection with actual extraction, or whether he may, because of the peculiar nature of a bonus payment made without respect to extraction, make a depletion deduction against it as provided in the Regulations.

The broad language of the Revenue Act of 1918 does not support the view that Congress intended that the depletion allowance should always be required to keep step with actual extraction. Indeed, in giving the Commissioner a large discretion in dealing with depletion it indicated the contrary. This conclusion is strengthened by the fact that the depletion provisions have been reenacted without change five times during a thirteen-year period in which the Regulations have consistently provided that a depletion deduction may be allowed in advance of extraction. Because of the peculiar wasting nature of mineral assets, Congress has permitted taxpayers to take depletion deductions to compensate them for the consumption of their capital. Ordinarily the deduction keeps step with extraction and is applied against the very income produced by the extraction. This results from the fact that the income is received and the extraction takes place simultaneously. In the case of a bonus, however, the income is received before actual extraction. The essential element to be considered in dealing with the bonus is that it is just as much a payment for the oil to be extracted as the royalty is for oil that is extracted. The bonus is in effect an advance royalty, and hence a depletion deduction should be allowed against it in the year when received. Only in this way can the fundamental purpose of the Revenue Acts to tax true annual net income be effectuated. The rule adopted by the Board, that no depletion deductions can be allowed

against a bonus, results in distortion of the annual net income. The opportunistic nature of petitioner's argument in support of the Board's view is shown by the facts that that is the least favorable rule to taxpayers in general, and is in all probability urged here only because petitioner paid no income or excess-profits taxes on the bonuses when it received them and the assessment of such taxes is now barred.

The Circuit Court of Appeals did not abuse its discretion in refusing to remand the case to the Board of Tax Appeals under the circumstances of this case.

ARGUMENT

I

THE AMENDED REGULATION IS VALID

It is no longer open to question that neither an operating owner nor a lessor nor a lessee is entitled as a matter of right to make any deduction from gross income on account of the extraction of the oil which produces the income. *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 114; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 304.

In the Corporation Excise Tax Act of 1909 (c. 6, 36 Stat. 11, 112, Sec. 38) Congress failed to make provision for any deduction on account of the depletion of mineral reserves. Because of the peculiar character of mineral properties and the hardship resulting from the omission of a depletion allowance, Congress provided for some deduction

in the later Revenue Acts. *United States* v. *Ludey*, 274 U. S. 295, 303. In the Income Tax section of the Tariff Act of October 3, 1913 (c. 16, Sec. II, 38 Stat. 114, 166–167) an allowance was made, but it was attacked on the ground that it was wholly inadequate. This Court sustained the right of Congress to put an arbitrary limit on the allowance. *Stanton* v. *Baltic Mining Co., supra.*

In the case of oil and gas wells, the Revenue Act of 1916 (c. 463, 39 Stat. 756, 767) provided for "a reasonable allowance for actual reduction in flow and production." Section 12 (a) Second.

The Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1077) provided in the case of oil and gas wells that there may be deducted from gross income "a reasonable allowance for depletion * * * according to the peculiar conditions in each case." Section 234 (a) (9).

The Commissioner immediately exercised the broad discretion thus given him. By Article 215 of Regulations 45 (*infra*, p. 28, issued April 17, 1919) it was provided that where a lease of mining property required the lessee to pay annual minimum royalties, which would entitle him to actual extraction of the number of units paid for, a depletion deduction should be allowed to the lessor to the extent of the value in the ground of the number of units paid for by the minimum royalty. This was a clear recognition of the power conferred upon the Commissioner to allow depletion in accordance with the basic purpose of the Revenue Acts—to tax

true annual net income—rather than to apply rigidly, and without regard to the varying arrangements which might be made for payments on mineral leases, the principle that the depletion allowance must keep step with actual extraction.

In the 1920 edition of Regulations 45 (issued January 28, 1921) Article 215 was amplified. (See *infra*, p. 29.) The original Article became 215 (b), and Article 215 (a) was added, providing that a bonus paid to a lessor in addition to royalties should be regarded as a return of capital, but only to the extent of the capital remaining to be recovered through depletion by the lessor. These provisions were retained intact in Article 215 (a) and (b) of Regulations 62 under the Revenue Act of 1921, Article 216 (a) and (b) of Regulations 65 under the Revenue Act of 1924, and Article 216 (a) and (b) of Regulations 69 under the Revenue Act of 1926. On November 13, 1926, Article 215 (a) of Regulations 45 and 62, and 216 (a) of Regulations 65, were amended by T. D. 3938 to provide that when a lessor of oil property received a bonus in addition to royalties, a depletion deduction should be allowed with respect to the bonus to the extent of that proportion of the basic value which the bonus bore to the sum of the bonus and the expected royalties. This provision was continued in Article 236 (a) of Regulations 74 under the Revenue Act of 1928, and the minimum royalty provision in Article 236 (b) of the same Regulations. Meanwhile, the provision for depletion as it

appeared in the Revenue Act of 1918 was continued without substantial change in the Revenue Acts of 1921, 1924, 1926, 1928, and 1932.

The sole question in the present case is one of statutory construction. No constitutional question is involved. Compare *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 304. This follows from the cases cited *supra* to the effect that there is no constitutional right to a deduction for depletion in the case of wasting assets. The question of construction presented is whether the provision for depletion, despite the general language used and the specific grant of a discretionary power to the Commissioner to make Regulations, implicitly imposes a requirement that the depletion deduction be coincident with actual extraction. The history of the depletion provisions given above carries conviction that Congress did not intend that there should be any such restriction, since the reenactments of the depletion clause without change during a thirteen-year period in which the Treasury Regulations had consistently provided that a depletion allowance should be made without regard to actual extraction within the year must be taken to have approved an interpretation of the depletion allowance which did not require it to keep step with actual extraction. See *National Lead Co.* v. *United States*, 252 U. S. 140, 146–147; *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235; *Brewster* v. *Gage*, 280 U. S. 327, 337; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 307–308; *United States* v. *Kirby Lumber Co.*, 284

U. S. 1. This conclusion is fatal to petitioner's argument that the inherent nature of the depletion deduction is such that it must be coincident with actual extraction.

Our position is that the Commissioner was justified in allowing a depletion deduction against a bonus received by a lessor of oil property, since only in that way could he give effect to the fundamental intent of the Revenue Acts to tax true annual net income. It is true that where no cash bonus is involved the depletion allowance is made in step with the exhaustion of the resources; but it is also true that in such cases the deduction is applied against the very income produced by such exhaustion. In contemplation of law the cash bonus bears the same relation to the exhaustion of the resources as the royalty payments. The bonus is royalty paid in advance [5] and it involves no departure from established principles of depletion to require deduction of the depletion allowance from the bonus when received by the lessor. If royalty payments are anticipated by payment of a bonus, there is nothing in the theory of depletion nor in the mandate of the statute which would prevent the allowance of a depletion deduction in advance of actual exhaustion. The underlying purpose of the statute requires that it be so administered as to reflect with accuracy the annual income

[5] See *Burnet* v. *Harmel*, decided November 7, 1932, No. 26, October Term, 1932.

upon which the tax is laid, and it is important that the true annual net income should be taxed and to this end that the depletion allowance should be applied to all of the income as and when received. This can only be accomplished as the amended Regulation requires by applying the deduction for depletion to bonus payments and royalty payments alike. In cases involving a bonus—an advance royalty—the receipt of the royalty in advance requires the allowance of the depletion deduction in advance of the extraction, to the end that true income may be reflected. Since the lessor has granted the right to take oil and has been paid in advance, he has in effect been paid for the depletion which will occur upon extraction by the lessee and it is from such payment that depletion must be deducted if net income is to be correctly determined.

The depletion deduction is allowed to a taxpayer to compensate him for the partial exhaustion of his mineral reserves. The theory is that since the gross income from the operation of mineral properties represents a return not only from the *use* of capital but from its partial *exhaustion,* a deduction should be allowed to the extent of the latter in computing the income tax. The nature of the depletion deduction was described by this Court in *United States* v. *Ludey,* 274 U. S. 295, 302, as follows:

> The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any

> year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed.

Where the owner of the oil well is also the operator, the problem of calculating depletion is easily solved. The basic value of the property is divided by the estimated number of barrels of oil in the ground, and the quotient is the unit of depletion. Each year thereafter the proceeds of the sale of oil are treated as gross income, from which is deducted a sum calculated by multiplying the number of barrels extracted during the year by the unit of depletion. See Article 210 of Treasury Regulations 45, under the Revenue Act of 1918.

The problem is likewise easy of solution where a lessor of oil properties receives only royalties depending upon production. The lessor reports the royalties as income, and a depletion allowance is made in the same year, calculated by multiplying the number of barrels extracted during the year by the lessor's unit of depletion (ascertained as in the case of the operating owner, *supra*). In both these cases the depletion allowances keeps step with ac-

tual exhaustion of the oil reserves, and the depletion deduction is applied against the very income which resulted from the extraction of oil in that year, so that the tax falls only upon the true net income for the year.

The problem is somewhat complicated where, as in the instant case, the lessor receives a bonus in addition to royalties based upon production. The essential fact to be borne in mind in considering the nature of a bonus is that it is an advance or supplemental royalty—in effect, a part of the royalty in a lump sum or down payment. It was so held by this Court in *Work* v. *Mosier,* 261 U. S. 352, 357–358. See also *Burnet* v. *Harmel, supra; Burkett* v. *Commissioner,* 31 F. (2d) 667 (C. C. A. 8th), certiorari denied, 280 U. S. 565; *Berg* v. *Commissioner,* 33 F. (2d) 641 (App. D. C.), certiorari denied, 280 U. S. 598; *Alexander* v. *King,* 46 F. (2d) 235, 239–240 (C. C. A. 10th), certiorari denied, 283 U. S. 845; *Ferguson* v. *Commissioner,* 59 F. (2d) 891 (C. C. A. 10th); *Hirschi* v. *United States,* 67 C. Cls. 637, certiorari denied, 280 U. S. 576; *Appeal of Nelson Land & Oil Co.,* 3 B. T. A. 315, 326; *State ex rel. Inter-State Iron Co.* v. *Armson,* 166 Minn. 230. Cf. *United States* v. *Biwabik Mining Co.,* 247 U. S. 116, 121.

This view is sound, because bonus and royalties alike are the consideration derived by the lessor from the use of property which is wasted in use. The fact that the oil reserve has not been extracted

when the bonus is paid is unimportant. The important consideration is that the lessor has been paid an advance royalty and to that extent has been paid for the exhaustion even though it has not yet occurred. Depletion must be applied to income derived from the use of the property which consumes it, and in so far as the lessor is concerned, that income comprises bonus as well as royalty.

Our contention that a bonus is advance royalty is also supported by decisions in cases where lessee taxpayers sought to deduct the entire bonus as a business expense in the year in which paid. It has uniformly been held in such cases by the Bureau of Internal Revenue,[6] by the Board of Tax Appeals,[7] and by the courts [8] that such a bonus is ad-

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[6] Article 109, Treasury Regulations 45 and 62; Article 110, Treasury Regulations 65 and 69; Article 130, Treasury Regulations 74; I. T. 1711, II–2 C. B. 104; A. R. R. 6459, III–1 C. B. 138.

[7] *Nelson Land & Oil Co.*, 3 B. T. A. 315, 325–326; *Burkett* v. *Commissioner*, 7 B. T. A. 560, affirmed, 31 F. (2d) 667 (C. C. A. 8th), certiorari denied, 280 U. S. 565; *Hazlett* v. *Commissioner*, 10 B. T. A. 332, 337; *Parkey* v. *Commissioner*, 16 B. T. A. 441, 445; *Baton Coal Co.* v. *Commissioner*, 19 B. T. A. 169, affirmed, 51 F. (2d) 469 (C. C. A. 3d), certiorari denied, 284 U. S. 674; *Ferguson* v. *Commissioner*, 20 B. T. A. 130, 131, reversed, 45 F. (2d) 573 (C. C. A. 5th); Klein, Federal Income Taxation, p. 439. Cf. *Waggoner* v. *Commissioner*, 24 B. T. A. 657.

[8] *Central Nat. Bank* v. *United States*, 283 Fed. 368, 373 (C. C. A. 8th), dismissed, 264 U. S. 600; *Alland & Bro.* v. *United States*, 28 F. (2d) 792 (Mass.); *Hirschi* v. *United States*, 67 C. Cls. 637; *Burkett* v. *Commissioner*, *supra*; *Baton Coal Co.* v. *Commissioner*, *supra*; *Galatoire Bros.* v.

vance rental or royalty, and that the deduction must be taken over the life of the lease.

We submit that unless the bonus is treated as an advance royalty and a depletion allowance made against it the underlying purpose of the Revenue Acts will be defeated. This Court has repeatedly pointed out that that purpose is to tax true annual net income. *United States* v. *Anderson,* 269 U. S. 422; *United States* v. *Mitchell,* 271 U. S. 9; *Aluminum Castings Co.* v. *Routzahn,* 282 U. S. 92; *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359; *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301; *Woolford Realty Co.* v. *Rose,* 286 U. S. 319. The purpose can not be effectuated with respect to bonus payments unless they are treated as advance royalties and an allowance made against them for depletion.

If the depletion allowance must always await actual extraction, as contended by petitioner, it will not, in the case of a bonus, be used as an offset against that part of the income which is represented by the bonus. In the present case, for example, the bonuses were paid between 1913 and 1918. Extraction took place not only in those years but also in 1919 and 1920 (the taxable years now in question) and presumably for a number of years thereafter. (There was a reserve of about 3,400,00 barrels of oil in the Coyote property at the end of 1920.)

Lines, 23 F. (2d) 676 (C. C. A. 5th). See *Constantine* v. *Wake*, 1 Sweeny (N. Y.) 239, 244; *Crile* v. *Commissioner*, 55 F. (2d) 804 (C. C. A. 6th). Cf. *Jennings & Co.* v. *Commissioner*, 59 F. (2d) 32 (C. C. A. 9th).

(R. 251.) The true return to petitioner in any year was not the amount of the royalties for that year but the sum of the royalties plus the portion of the bonuses allocable to the extraction of that year.

If we apply petitioner's theory that no depletion deduction may be made with respect to the bonuses, the result will be a distortion in petitioner's income. Against the income received by petitioner in 1919 and 1920, which is only a portion of the income attributable to the oil extracted in those years, will be allowed a depletion deduction for its entire interest in the quantity of oil then extracted. Hence petitioner's calculation of its net income for those years does not reflect its true income, the calculation being less than the true net income to the extent of the portion of the bonuses allocable to those years. On the other hand, petitioner's net income for the years when the bonuses were paid would be distorted in the opposite direction by treating the bonuses as petitioner urges, since in such case no depletion deduction would be allowed against them, despite the fact that the bonuses represented a payment for oil to be extracted. This would result in petitioner's calculated net income for those years being higher than the true net income.

These considerations reveal how completely opportunistic is petitioner's argument in the present case. If the instant case had arisen in 1918 petitioner would scarcely have contended that no deple-

tion deduction could be taken against the bonus paid in that year, since upon that theory it would then have had to pay income and excess-profits taxes for the year out of all proportion to the true annual net income.

The position taken by petitioner that no depletion allowance may be made with respect to a bonus is less favorable to taxpayers in general than either the original or amended Regulation.[9] Even after the excess-profits tax was repealed, refusal to permit a depletion allowance against a bonus would, in the case of individual taxpayers (although not in that of corporations) result in a disproportionate tax for the year in which the bonus was received by bringing the total sum up into the higher brackets. Moreover, under the rule urged by petitioner the taxpayer's annual depletion deductions based upon actual extraction might not return to him the entire value of his mineral reserves as of the basic date. If they did not, the taxpayer would be in the position of having paid taxes upon a sum greater than the total net income derived by him from his oil well. Petitioner's advocacy of a rule which would produce these incongruous results must be based upon the fact that it escaped taxation upon the bonus payments when received and that assessment of taxes with respect to them is now barred by the statute of limitations.

---

[9] See Appendix B.

The original Regulation, which treated the bonus as a return of capital, was the most favorable rule possible for taxpayers, since under that Regulation no income or excess-profits tax would be paid upon the bonus. Instead of paying a high excess-profits tax upon the bonus, or in the case of an individual the high income tax of the upper brackets, the taxpayer would, in each year of extraction, pay taxes at a lower rate, based, in effect, upon the sum of the royalties received in, and the portion of the bonus allocable to, that year. This would result from the decrease in the unit of depletion worked by deducting the total amount of the bonuses from the capital sum returnable through depletion. The result of thus decreasing the unit of depletion would be the same in any given year as that of increasing the income by a proportionate share of the bonus.

While the validity of the original Regulation is immaterial if the Court accepts our contention that the amended Regulation is valid, it should perhaps be pointed out that there is no inconsistency in holding that the total amount of the bonus must be reported as gross income, and in holding that bonus is to be regarded as a return of capital for purposes of computing depletion. The purpose of the depletion allowance, consistently expressed in the Treasury Regulations,[10] is that the taxpayer may recoup free of tax the value of the mineral re-

[10] Reg. 33, Art. 142; Reg. 45, Art 201; Reg. 62, Art 201; Reg. 69, Art. 201; Reg. 74, Art 221.

serves as of the basic date. This sufficiently shows that the depletion deduction is regarded as a return of capital. Thus the original Regulation meant merely that depletion to the extent of the entire bonus should be taken as a deduction from the bonus. This was a convenient rule of thumb to apply to a necessarily complicated situation, and, as already indicated, operated most favorably to taxpayers. The fact that Congress reenacted the depletion provisions without change three times (in the Acts of 1921, 1924, and 1926) while the original Regulation was in force is strong evidence that Congress approved of such an interpretation of the statute. See cases cited *supra,* p. 12.

However, the original Regulation was amended not long after the Board's decision in *Appeal of Nelson Land & Oil Co., supra,* by T. D. 3938 (*infra,* p. 31). It is difficult to see how the amended Regulation can be objectionable. It does not distort the amount of taxable income either in the years of receipt of the bonuses or subsequently. It strictly enforces the fundamental intent of Congress to tax true annual net income. It provides a variable but logical and workable rule which fits each case by making the amount of the depletion deduction turn upon the relationship between the bonus and the sum of the bonus and expected royalties. Indeed, the Board itself recognized that the amended Regulation might operate more equitably than the rule which it adopted. (R. 246.)

In holding that it is contrary to the depletion concept to make a depletion allowance except with reference to actual extraction, the Board disregarded the fact that the depletion provisions had been reenacted without change five times despite the existence of Regulations providing for depletion deductions in years other than that of actual extraction (see *supra, pp.* 11–12), and twice since the promulgation of the amended Regulation. We submit, as the court below held (R. 290), that the amended Regulation not only does not conflict with the statute but clearly conforms to it.

Petitioner urges that the decisions of this Court in *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301, and *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364, are decisive in its favor. It is true that the language used by this Court in those cases supports the view that depletion keeps step with actual extraction. That is generally true. (*Supra,* p. 13.) Our position is that because of the peculiar nature of bonuses a depletion deduction must be made against them when received, even though in advance of extraction, since only by that method may the true annual net income be determined. The question of the treatment of bonuses was not presented in either of the two cases cited, and the Court, in using the language referred to, probably had in mind current royalties only.

II

THE CIRCUIT COURT OF APPEALS DID NOT ABUSE ITS DISCRETION IN DECLINING TO REMAND THE CASE FOR FURTHER HEARING

At the hearing before the Board of Tax Appeals the petitioner failed to prove the amount of the royalties expected to be received under the lease. This is one of the essential elements in the computation of the depletion allowance under the amended Regulation (*infra,* p. 31). That Regulation was promulgated as T. D. 3938 on November 13, 1926 (V–2 C. B. 117), and had been in effect nearly two years when the depletion question here involved was first raised by the petitioner in its second amended petition to the Board of Tax Appeals on September 21, 1928. (R. 38.)

The hearing before the Board took place on October 22, 1928, and the Government filed its brief pointing out the Commissioner's error in failing to apply the amended Regulation on January 5, 1929. Petitioner filed its brief on January 21. Although the Board did not decide the case until more than two months later (March 30; see R. 3), petitioner made no application in the interim for an opportunity to bring itself within the amended Regulation.

Petitioner went before the Board upon the theory that no deduction for depletion was per-

missible with respect to the bonuses in the year of their receipt. It ignored the amended Regulation and failed to show the amount of royalties expected to be received under the lease, an essential factor in the application of the Regulation. In these circumstances the Circuit Court of Appeals held that the computation made by the Commissioner under the original Regulation must stand. (R. 291.)

Since the Circuit Court of Appeals reversed the decision of the Board, it had power, under Section 1003 (b) of the Revenue Act of 1926 (*infra*, p. 28), to remand the case for rehearing. But we submit that it was not required to do so, and that under the circumstances there was no abuse of discretion. In order that the burden of proof rule may be given its proper effect and that litigation may come to an end, the taxpayer should be required to prove its case in the first instance, at least where, as here, it has had the opportunity of doing so. Cf. *Toledo Scale Co.* v. *Computing Scale Co.*, 261 U. S. 399, 424–425.

CONCLUSION

The judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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G. A. YOUNGQUIST,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
SEWALL KEY,
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Special Assistants to the Attorney General.
WILBUR H. FRIEDMAN,
Attorney.

NOVEMBER, 1932.

APPENDIX A

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077:

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this par-

agraph shall be equitably apportioned between the lessor and lessee;

* * * * *

Revenue Act of 1926, c. 27, 44 Stat. 9, 109, 110:

SEC. 1001. (a) The decision of the Board rendered after the enactment of this Act (except as provided in subdivision (j) of section 283 and in subdivision (h) of section 318) may be reviewed by a Circuit Court of Appeals, or the Court of Appeals of the District of Columbia, as hereinafter provided, if a petition for such review is filed by either the Commissioner or the taxpayer within six months after the decision is rendered.

* * * * *

(U. S. C. Sup. V, Title 26, Sec. 1224.)

SEC. 1003. (b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require. (U. S. C. Sup. V, Title 26, Sec. 1226.)

Article 215 of Treasury Regulations 45 under the Revenue Act of 1918 (unrevised; promulgated April 17, 1919) provided as follows:

ART. 215. *Depletion of mine based on advance royalties.*—Where the owner has leased a mining property for a term of years with a requirement in the lease that the lessee shall mine and pay for annually a specified number of tons or other agreed units of measurement of such mineral, or shall pay annually a specified sum of money which shall be applied in payment of the purchase price or agreed royalty per unit of such mineral whenever the same shall thereafter be mined and removed from the

leased premises, the value in the ground to the lessor for purposes of depletion of the number of units so paid for in advance of mining will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the mining or removal in such year of any ore or mineral so paid for in advance and for which deduction has been once made. If for any reason any such mining lease shall be terminated before the ore or mineral therein which has been paid for in advance has been mined and removed, and the lessor repossesses the leased property, an amount equal to the aggregate deductions for depletion allowed in respect of ore or mineral not mined and removed by the lessee, but still in the ground, will be deemed income to the lessor and will be returned as such for the year in which the property is repossessed.

Treasury Department Regulations 45 (1920 Edition):

ART. 215. *Depletion—Adjustments of accounts based on bonus or advanced royalty.*—(*a*) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through deple-

tion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition.

(*b*) Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If, for any reason, any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed, and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is ter-

minated or the property repossessed, and the tax thereon paid.

(d) Upon the expiration, termination, or abandonment of a lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account so much of the bonus received and deducted from capital recoverable through depletion as is in excess of the actual depletion or loss in value sustained as a result of the operations under the lease and the corresponding amount will be income for the year in which the lease expires, terminates, or is abandoned.

Article 215 of Regulations 62 and Article 216 of Regulations 65 are substantially the same as Article 215 above quoted.

T. D. 3938, V–2 C. B. 117:

Article 215 of Regulations 45 (1920 edition), article 215 of Regulations 62, and article 216 of Regulations 65 are hereby amended to read as follows:

ART. 216 (215). *Depletion—Adjustments of accounts based on bonus or advanced royalty.*—(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.

(b) Where the owner has leased a mineral property for a term of years with a

requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed, and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is terminated or the property repossessed, and the tax thereon paid.

(d) Upon the expiration, termination, or abandonment of the lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be re-

quired to restore to capital account the excess of the depletion theretofore allowable in respect of the bonus and royalty payments over the actual depletion or loss in value sustained as a result of the operations under the lease, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

All rulings inconsistent herewith are hereby revoked.

Approved November 13, 1926.

This Treasury Decision appears as Article 216 of Regulations 69 and Article 236 of Regulations 74.

APPENDIX B

The results of various methods of treating a bonus may be demonstrated as follows:

Assume the following facts:

A owned a developed oil property in fee at March 1, 1913. The fair market value of the oil and gas rights at March 1, 1913, was $3,000,000. The estimated oil reserves at March 1, 1913, were 6,000,000 barrels. From March 1, 1913, to Dec. 31, 1917, 2,000,000 barrels of oil were produced and sold from the property. Consequently the capital sum remaining to be recovered through depletion at January 1, 1918, was $2,000,000, and the remaining recoverable oil reserves were 4,000,000 barrels. In the following examples these amounts are referred to as the "Capital Sum" and the "Reserves," respectively.

On January 1, 1918, A leased the property to B. The lease provided for the customary lessor's royalty of one-eighth, and B paid A a bonus of $600,000. In the light of market conditions at the date of the lease the royalties expected under the lease were $1,000,000. 800,000 barrels of oil were produced and sold from the property during 1918.

Apply the above facts in each of the following cases:

Case I. If Article 215, Regulations 45, before amendment, is the correct statement of the law.— That is, regard the bonus as a nontaxable return of capital to the full extent that there is capital to be returned through depletion. Reduce the capital sum by the amount of the bonus and permit the

remainder of the capital sum to be returned through ordinary depletion deductions as the ordinary royalties are received, concurrent with the production and sale of the oil.

Case II. If Treasury Decision 3938, amending Article 215, Regulations 45, is the correct statement of the law.—That is, treat the bonus and ordinary royalties as income but allow a depletion deduction because of the bonus in an amount equal to that portion of the capital sum which is represented by the ratio of the bonus to the sum of the bonus and the royalties expected under the lease. After making this depletion allowance permit the remainder of the capital sum to be returned through ordinary depletion deductions as the ordinary royalties are received, concurrent with the production and sale of the oil.

Case III. If the decision of the Board of Tax Appeals in the Murphy Oil Company case is the correct statement of the law.—That is, treat the bonus and ordinary royalties as income; allow no depletion deduction because of the bonus, but permit the entire capital sum to be returned through ordinary depletion deductions as the ordinary royalties are received, concurrent with the production and sale of the oil.

The results of computation under the three cases appear in the following tabulation:

	Case I (original regulation)	Case II (amended regulation)	Case III (B. T. A. decision)
(a) Capital sum, Jan. 1, 1918	$2,000,000	$2,000,000	$2,000,000
(b) Reserves, Jan. 1, 1918 ..... barrels	4,000,000	4,000,000	4,000,000
(c) Bonus	$600,000	$600,000	$600,000
(d) Royalties expected under the lease	$1,000,000	$1,000,000	$1,000,000
(e) Gross production, 1918 ..... barrels	800,000	800,000	800,000
(f) Lessor's one-eighth, 1918 ..... do	100,000	100,000	100,000
(g) Deduction allowable in 1918 because of the bonus	$600,000	$750,000	None.
(h) Capital remaining to be returned through depletion concurrent with ordinary royalties	$1,400,000	$1,250,000	$2,000,000
(i) Deduction allowable in 1918 as depletion with respect to ordinary royalties	$280,000	$250,000	$400,000
(j) Total allowable deductions for depletion or return of capital in 1918	$880,000	$1,000,000	$400,000
(k) Capital remaining to be recovered through depletion after 1918	$1,120,000	$1,000,000	$1,600,000
(l) Total ultimate allowable deductions for return of capital, 1918 and later	$2,000,000	$2,000,000	$2,000,000

NOTE.—(1) Item (g) in Case II is determined as follows:

$$\text{Bonus depletion} = \frac{\text{Bonus (600,000)}}{\text{Bonus (600,000), plus expected royalties (1,000,000)}} \times \frac{}{\text{Capital sum (2,000,000)}} = \$750{,}000.$$

NOTE.—(2) Item (i) in each case is one-fifth of item (h), because the production in 1918 used up one-fifth of the oil reserves remaining at the beginning of 1918.

U. S. GOVERNMENT PRINTING OFFICE: 1932

APPENDIX C

TREASURY DEPARTMENT,
BUREAU OF INTERNAL REVENUE,
Washington, October 29, 1932.

Hon. G. A. YOUNGQUIST,
Assistant Attorney General,
Washington, D. C.

In re Murphy Oil Company, Whittier, Calif., B. T. A. No. 14440, C. C. A. Nos. 6388–6459, C. C. A. 9th Circuit. Sup. Ct. No. 955.

SIR: In accordance with the request of your office that you be advised in connection with the way in which the Murphy Oil Company treated the $5,500,000.00 received by it from the Standard Oil Company of California as a bonus for a lease entered into in December, 1913, you are advised as follows:

On the original return for 1913, the Murphy Oil Company reported income from the bonus in the amount of $1,108,600.97 and paid a tax on the total net income reported for such year of $14,816.54. The Acting Commissioner, G. E. Fletcher, on November 13, 1915, increased the net income of the Murphy Oil Company for 1913 by $1,446,637.19 and caused additional assessment of $14,476.37 to be made. This additional assessment was also paid. On January 7, 1920, the Murphy Oil Company filed an amended income-tax return for the year 1913, reporting income from the bonus received from the Standard Oil Company in the

amount of $5,108,600.97, which indicated a total tax liability of $54,531.11, or an additional tax above that previously paid of $25,238.20. This additional tax apparently was assessed in 1920, but was never paid. The Murphy Oil Company for the years 1914 to 1918, inclusive, did not report any of the bonus received during such years as income either upon its original returns or upon its amended returns for such years.

The Bureau, when it audited the returns for the years 1913 to 1918, inclusive, for which years overassessments were scheduled on February 21, 1924, excluded all of the $5,500,000.00 received from the Standard Oil Company from gross and net income for the year 1913 and added no portion of it to income for any other year. As a result of such Bureau audit, it was found that by eliminating all of the bonus, the Murphy Oil Company's tax liability for the year 1913 was $3,456.51. The remainder of the $54,531.11 which had been previously assessed, was abated to the extent of $25,238.20 and refunded to the extent of $2,740.26, or a total of $27,978.46 was either refunded or abated. The remainder of the overassessment, or $23,096.14, was not refunded because the statute of limitations had run against the making of such a refund.

Therefore, an examination of the file clearly shows that no tax was ever assessed or paid with respect to the bonus received from the Standard Oil Company except for the year 1913 and of all the tax assessed or paid for such year with respect to such bonus, all except $23,096.14 was refunded.

Respectfully,

C. M. CHAREST,
General Counsel.

U. S. GOVERNMENT PRINTING OFFICE: 1932

FILE COPY

No. 80.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

PETITION FOR REHEARING.

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THE COURT PRESS, INC.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 80.

MURPHY OIL COMPANY, a Corporation,
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

PETITION FOR REHEARING.

COMES NOW the above named petitioner, Murphy Oil Company, by its attorney, Randolph E. Paul, and presents this its petition for a rehearing of the above entitled cause under Rule 33 of the Revised Rules of the Supreme Court of the United States, and in support thereof respectfully shows:

Judgment was entered on December 5, 1932.

The opinion of this Honorable Court establishes certain principles which dispose of the propositions formerly urged by petitioner. This petition is not an attempted reiteration of these rejected arguments in the guise of an attack upon the language of the opinion. We ask a rehearing only in order to obtain for this taxpayer the benefit of the application of the principles now settled by the Court. Unless this Court reconsiders the specific result in this case, we shall find ourselves the only taxpayer denied the boon of the decision reached in our own case—that royalties may be entirely a return of capital.

The two principal propositions of the opinion of this

Court are: (1) that there is no distinction between a bonus and royalties (following *Burnet* v. *Harmel,* decided November 7, 1932) with respect to the depletion allowance granted by the statute, and (2) that article 215 (a) as amended was "reasonable" within the meaning of the statute. The petitioner claims that it did not *in this very case* receive the benefit of this Honorable Court's opinion.

The Court, after referring to the lack of distinction between bonuses and royalties, states that the question remains (italics ours):

> "* * * whether the method followed by the Commissioner *in this case* in allocating depletion to bonus and royalties failed to afford that 'reasonable allowance' for depletion which the statute provides."

Discussing the amended regulation the Court then states that if the bonus and expected royalties together (italics ours):

> "* * * are not found to exceed the capital investment of the lessor, the entire bonus received in advance of royalties must be treated, after the amended regulation as well as before, *as a return of capital, since, in that case, the expected royalties added to the bonus are, by hypothesis, sufficient to return no more than the lessor's capital.*"

The Court adds:

> "Such was the case here."

Since there is no distinction between a bonus and royalties and since the bonus and expected royalties together are not found to exceed the capital investment of the lessor, it follows that the bonus is, in the language of the Court, "a return of capital". It follows inescapably

from this reasoning of the Court that the *royalties* also must be treated as a return of capital. There is no stopping short of this conclusion.

This has not been done. The deficiency herein, approved by the Circuit Court of Appeals, is a tax upon income consisting of royalties. The tax is on royalties which are, by hypothesis, "a return of capital".

While the Court clearly finds that the sum of the bonus and the expected royalties does not equal the invested capital of the taxpayer, the Commissioner may in answer urge that the reason for this conclusion is the failure of the taxpayer to prove expected royalties. This being a matter of adjective law, we have discussed it in an appendix to this petition, to which the Court's attention is respectfully directed.

It is respectfully submitted that under the Court's decision in *Burnet* v. *Logan*, 283 U. S. 404, the petitioner herein received no taxable income until all its capital sum (the value of its property at March 1, 1913) had been returned either in the form of bonus or royalties.

Petitioner regrets that its unavoidable delay in filing a supplemental brief after the oral argument may have prevented the adequate consideration by this Honorable Court of the facts bearing upon the good faith of its argument to the Court and of the arguments bearing upon the question of legislative approval of the regulation in question.

It is obvious that the opinion herein has taken a strange and unexpected turn which neither litigant could reasonably have anticipated. It is a simple matter of doing justice, therefore, to remand the case. *Underwood* v. *Commissioner*, 56 F. (2) 67, 73 (C. C. A. 4th 1932) remanding 20 B. T. A. 1117. Under this Court's opinion, both bonus and royalties were a return of capital if together they did not exceed the capital sum. They were in part a return of

capital and in part income if together they amounted to more than the capital sum. The facts in this regard should be ascertained. It is, therefore, prayed that this petition for rehearing be granted and that the cause be remanded in order that these facts may be ascertained and justice done.

Respectfully submitted,

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Certificate of Counsel.

I, RANDOLPH E. PAUL, counsel for the above named petitioner, Murphy Oil Company, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

RANDOLPH E. PAUL,
Counsel for Petitioner.

APPENDIX.

It is to be noted that the deficiency in this case was assessed by the Commissioner on February 6, 1926 (RI-18),* prior to the promulgation of the amended regulation on November 13, 1926. The sixty-day letter proposing the deficiency was based upon the original regulation considering the bonus entirely a return of capital and allowing depletion, measured by production, upon the reduced base. It was upon this sixty-day letter that the pleadings in the case were based.

Had the sixty-day letter issued after the promulgation of the amended regulation, it would have been the duty of the Commissioner to have himself estimated the expected royalties and, in the event that these expected royalties when added to the bonus did not equal the taxpayer's capital sum, the Commissioner would have been obliged to have allowed the expected royalties entirely as a return of capital in accordance with the amended regulation (and in accordance with the opinion of this Honorable Court in this very case). By promulgating the amended regulation after the issue of the sixty-day letter, the Commissioner places taxpayer at a tremendous disadvantage in that the Commissioner in proposing the deficiency attempts to avoid the necessity of complying with the amended regulation but requires the taxpayer itself to prove expected royalties on the theory that it has not only the burden of proof to establish that the deficiency proposed by the Commissioner is wrong but also the burden of proof to show what the proper tax is. As a matter of fact, the amended regulation was first injected into the proceedings *after* the hearing before the Board of Tax Appeals and in the brief of the Government.

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* The record is a consolidation of the record in two appeals, there is therefore a duplication of page numbers. The figure I refers to the record in No. 6388.

For the Court to deprive this taxpayer of the practical advantages of the principles now enunciated by it simply because taxpayer did not prove expected royalties is, it will be seen, to punish taxpayer severely for a situation which arose entirely because of the promulgation of the amended regulation after the issue of the sixty-day letter.

Taxpayer justifiably assumed that the Commissioner intended the amended regulation to be prospective only in its operation, since the new regulation had been in existence nearly two years at the time of trial and yet the Commissioner allowed the trial to proceed on the theory of the old regulation. When the Commissioner did shift his position to the amended regulation, in his brief, the proofs were closed.

SUPREME COURT OF THE UNITED STATES.

No. 80.—October Term, 1932.

Murphy Oil Company, Petitioner, *vs.* David Burnet, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[December 5, 1932.]

Mr. Justice Stone delivered the opinion of the Court.

This case is here on certiorari, 286 U. S. 541, to review a judgment of the Court of Appeals for the Ninth Circuit, 55 F. (2d) 17, which reversed an order of the Board of Tax Appeals, 15 B. T. A. 1195, and sustained a ruling of the Commissioner of Internal Revenue fixing the amount of depletion to be allowed and deducted from royalties received by petitioner in 1919 and 1920 as the lessor of oil lands, in determining petitioner's taxable income for those years.

In December, 1913, petitioner, the owner of two tracts of oil lands, leased them for stipulated net bonus payments, aggregating $5,173,595.18 and royalties of one-fourth of the oil produced by the lessee. All the bonus payments were made before 1919. Whether petitioner returned those payments as income or paid income tax on them for the years when received does not appear. During 1919 and 1920 petitioner received royalties from the leased lands. In returning its income for those years, it sought to deduct from the royalties received the entire original unit cost to it of the oil extracted during the taxable period, without any diminution by reason of the bonus payments which it had already received. Under the applicable Revenue Act of 1918, c. 18, 40 Stat. 1057, bonus and royalties received by the lessor of an oil lease, after deductions allowed by the taxing act, are taxable income of the lessor. See No. 26, *Burnet* v. *Harmel*, decided November 7, 1932. The question to be decided is whether the Commissioner correctly calculated the deduction for depletion for the years in question, by treating the bonus previously received by the petitioner, as a

return of capital and by reducing *pro tanto* the depletion allowed on the royalties received in later taxable years.

The court below sustained the Commissioner's treatment of the bonus payments as advanced royalties for which depletion must be allowed under § 234 (a) (9), Revenue Act of 1918, to the extent that they represent a return of capital, and held erroneous the conclusion of the Board of Tax Appeals that the entire bonus was taxable income. The correctness of this decision must first be determined, for if the Board was right in ruling that the bonus was not subject to a depletion allowance, the method of computing the depletion to be allowed on the royalties received during the taxable years in question would present no problem. The taxpayer would be entitled to deduct the full capital investment per barrel in the oil extracted during those years.

Section 234 (a) (9) of the 1918 Act includes in the authorized deductions from gross income:

"(9) In the case of mines, oil and gas wells, . . . a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: . . . such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee; . . ."

We think it no longer open to doubt that when the execution of an oil and gas lease is followed by production of oil, the bonus and royalties paid to the lessor both involve at least some return of his capital investment in oil in the ground, for which a depletion allowance must be made under § 234. See *Burnet* v. *Harmel*, *supra*. This is obvious where royalties alone are insufficient to return the capital investment. A distinction between royalties and bonus, which would allow a depletion deduction on the former but tax the latter in full as income, when received, making no provision for a reasonably anticipated production of oil on the leased premises, would deny the "reasonable allowance for depletion" which the statute provides. The harsh operation of such a rule with respect to taxpayers generally is apparent and is emphasized by the opportunist character of petitioner's argument here. The rule for which it contends can operate to its advantage

only if it fortuitously escapes payment of any tax on the bonus payments, which it insists shall be treated as income without the deduction of any depletion allowance.

Doubts, if any, whether the statute authorizes depletion of bonus payments, have been definitely set at rest by the repeated reenactment, without substantial change, of the provisions of § 234 (a) (9)[1], since the promulgation of treasury regulations providing for such depletion.[2] See *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 307-8; *Brewster* v. *Gage*, 280 U. S. 327, 337; *National Lead Co.* v. *United States*, 252 U. S. 140, 146-147.

The question remains whether the method followed by the Commissioner in this case in allocating depletion to bonus and royalties failed to afford that "reasonable allowance" for depletion which the statute provides.

Article 215, Treasury Regulations 45 (1920 ed.) provided:

"(a) Where a lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of the lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

This paragraph of the regulation was amended, November 13, 1926, by Treasury Decision 3938, V-2, C. B. 117, to read as follows:

"(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the

[1] § 234 (a) (9), Revenue Act of 1921, 42 Stat. 227, 256; § 234 (a) (8), Revenue Act of 1924, 43 Stat. 253, 284; § 234 (a) (8), Revenue Act of 1926, 44 Stat. 9, 42; § 23 (l), Revenue Act of 1928, 45 Stat. 791, 800; § 23 (l), Revenue Act of 1932, 47 Stat. 173, 180.

[2] Art. 215 (a), Treasury Regulations 45 (1920 ed.), Revenue Act of 1918, continued intact in Art. 215 (a), Treasury Regulations 62, Revenue Act of 1921; Art. 216 (a), Treasury Regulations 65, Revenue Act of 1924. The amendment of subdivision (a), November 13, 1926, by T. D. 3938, V-2 C. B. 117, appears in Art. 216 (a), Treasury Regulations 69, Revenue Act of 1926; Art. 236 (a), Treasury Regulations 74, Revenue Act of 1928. See also the minimum royalty provision in Art. 236 (b) of Regulations 74.

bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

The important difference in operation between the regulation before its amendment and after, is in the case where the Commissioner properly finds that the sum of the bonus and expected royalties exceeds the lessor's capital investment in the oil in the ground. If, for example, the bonus were $1,000,000 and the estimated royalties were $2,000,000 and the capital investment of the lessor in the oil in the ground, to be depleted, were $2,000,000, the allowed depletion for return of the capital investment would be deducted, one-third from the bonus and two-thirds from the royalties as received.

The regulation thus operates to distribute the lessor's anticipated profit or the taxable net income to be derived from the extraction of all the oil ratably between the bonus and royalties, so that the estimated profit element in each will be taxed as received, subject to such readjustments of capital account as are authorized by paragraphs (c) and (d) of the amended regulation, in the event of termination, abandonment, or expiration of the lease before all the oil is extracted. But if the bonus and expected royalties together are not found to exceed the capital investment of the lessor, the entire bonus received in advance of royalties must be treated, after the amended regulation as well as before, as a return of capital, since, in that case, the expected royalties added to the bonus are, by hypothesis, sufficient to return no more than the lessor's capital.

Such was the case here. In determining petitioner's depletion allowance for the two years in question, the Commissioner made no specific determination of the "expected royalties" from the leased lands. But such a determination was of consequence in allocating depletion to the bonus only in the event that the total of bonus and expected royalties exceeded the invested capital of the taxpayer. No facts appear which would have justified such a finding and, without it, the requirements of the amended regulation were satisfied by treating the whole bonus as a return of capital, and

deducting from the depletion allowance on each barrel of the royalty oil the proportion of the capital investment already returned by the bonus. This is what the Commissioner did.

He determined, on the basis of engineers' reports, the total amount of oil in the ground at the date of the lease and its value as of March 1, 1913. This he treated as petitioner's capital investment, to be returned by the depletion allowance. The computation necessarily revealed the per barrel capital investment in oil in the ground at the date of the lease. By making certain necessary capital investment adjustments, reflecting oil extraction during the years before 1919, the detail of which is not now important, he arrived at the per barrel capital investment of petitioner in oil in the ground in 1919 and 1920, the figure which would represent the actual amount of depletion of the capital investment for each barrel of oil extracted during those years, if there had been no bonus payments. His method of bringing the bonus into the computation amounted, in effect, to dividing the amount of the bonus by the total number of barrels of royalty oil in the ground, as indicated by the engineers' reports. The result represented the amount to be deducted from the depletion allowance per barrel of royalty oil which would otherwise have been made for those years. Stated in another way, the total amount of the bonus was deducted from petitioner's total capital investment in oil in the ground returnable by depletion allowances, with a corresponding reduction in the per barrel capital investment in the oil reserve. Thus the Commissioner treated the whole of the bonus as a return, in advance of abstraction of the oil, of a part of the petitioner's capital investment in the oil in the ground, with which it would part, in a technical legal sense, only upon abstraction. In consequence, the deduction for depletion allowed on royalties received in 1919 and 1920 was reduced; it is of this reduction that petitioner complains.

We think the Commissioner's method "reasonable" within the meaning of the statute. The deduction for depletion from the bonus payments, which the statute requires, must either be made after the process of extracting the oil is complete, to the extent that the royalties received have been insufficient to replace invested capital, with the attendant inconvenience of indefinite postponement of the allocation of the bonus to income and return of capital,

or a formula must be adopted by which the appropriate allocation may be made as the two classes of gross income, bonus and royalties, are received.

That formula the regulation purports to furnish. Where the estimates are reasonable, the formula affords a fair and convenient method of avoiding the present taxation of the bonus, when received, as income, in the face of the probability that it will ultimately prove not to be such. It will not fail to provide, with reasonable certainty, for the restoration of capital to which the taxpayer is entitled, if the oil extracted equals or exceeds the amount originally estimated. If less than that amount, it does not preclude revision and necessary adjustments, as errors appear probable. In addition, provision is made by subdivisions (c) and (d) of the regulation, as amended, for such necessary capital readjustments as may be occasioned by the termination, abandonment or expiration of the lease before all the oil is extracted.

The method of computation provided by the amended regulation must be taken to have received the approval of Congress, for, as already noted, the provisions of article 215 (a), as amended, have been continued in the Treasury Regulations since 1926 and those of § 234 (a) (9) of the Revenue Act of 1918 have been reenacted without substantial change in the Revenue Acts of 1928 and 1932.

The problem here is different from that involved in *Burnet* v. *Thompson Oil & Gas Co., supra.* There it was held, interpreting § 234 (a) (9), that the part of the depletion not allowed by the 1913 statute in the year in which it occurred could not be carried over and added to the depletable base used in computing the tax for a later year under the 1918 Act, which allowed depletion in full. Here an anticipated depletion of capital is to be returned from bonus and future royalties, to the extent that the applicable statutes allow, and the problem is to allocate such anticipated depletion to a payment made in advance of its occurrence. This allocation is permitted by the statute.

Petitioner argues, nevertheless, that the regulation is unreasonable because it requires the Commissioner to estimate probable royalties which are dependent on the frequently unforeseeable future market value of oil. But the regulation does not require him to make estimates which are unreasonable, for where none

can be made with reasonable accuracy the Commissioner cannot find that "the sum of the bonus and royalties expected to be received" exceeds the capital investment. In that event, the whole of the bonus will be treated, as in this case, as a return of capital. We cannot say that such a result is unreasonable on its face. The exigencies which "the peculiar conditions of each case" may present, we need not now consider. It is also unnecessary to inquire under what circumstances the application of the regulation may fail to comply with the statute because the appraisals which are made are extravagant or impossible. In the case before us the accuracy of every estimate of the Commissioner is unchallenged. It cannot be said that the regulation, as applied here, was unauthorized by the statute because inadequate for its purpose or inconvenient or unjust in its operation.

Finally, petitioner urges that as the Commissioner failed to find the expected royalties to be received under the lease, the court below should have exercised its discretion to remand the case to the Board of Tax Appeals for a rehearing. § 1003 (b), Revenue Act of 1926, 44 Stat. 9, 110. As we have said above, the record does not disclose any facts from which the expected royalties might be determined. Neither the petitioner nor the Commissioner asked opportunity to supply such facts. It does not appear whether such an estimate could be made, or that, if made, the sum of the bonus and expected royalties would exceed the petitioner's capital investment, returnable by depletion. Hence, no case was made calling for the court below to exercise its discretion in petitioner's favor.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.